INTERNATIONAL MONETARY COOPERATION

GEORGE N. HALM

CHAPEL HILL

1945

THE UNIVERSITY OF NORTH CAROLINA PRESS

Printed in the United States of America
Van Rees Press, New York

PJ

SECOND PRINTING

PREFACE

THE PURPOSE of this book is to explain the importance of the International Monetary Fund and to review the discussion which led to the Agreement of Bretton Woods. Rather than limit the investigation to a commentary on details of the proposed international organization, I have tried to contrast the Agreement with the earlier plans (particularly the Keynes Plan) and the alternatives offered by writers who were not willing to compromise.

While working on this book, my conviction grew that acceptance of the Fund proposal is the only practical way back to multilateral clearing. I hope that this book will convince others.

The field of international economics is full of unintelligible complexities for the layman. While I have tried to be as elementary as possible, I could not, of course, oversimplify the issues involved. To do so would have meant to give no explanation at all. But I trust that a patient and careful reader does not have to be an economist to understand the gist of the argument. For some of my fellow economists the book may be helpful because it summarizes a discussion and interprets documents with which they might not have been able to acquaint themselves in these hectic days.

It is hoped that the main documents appended will be found useful. To readers who cannot devote much time to the study of these plans I recommend the reading of the Joint Statement (Appendix III) which contains a concise formulation of the purposes and the structure of the International Monetary Fund. The Joint Statement has, however, been amended at Bretton Woods and cannot be depended upon in matters of detail.

I am greatly indebted to Professors Edward M. Bernstein, Gottfried von Haberler, Ervin P. Hexner, Albert E. Irving, Lewis F. Manly, and to Dr. Theodore Morgan for many valuable criticisms and suggestions, to Mr. Carmon M. Elliott for his faithful help with the first draft of the book, and to Miss Sina Spiker for seeing it through the press. I am particularly

grateful to Director W. T. Couch of the University of North Carolina Press for his suggestion to write about the new plans for international currency stabilization and the sympathetic understanding with which he saw the treatment grow into something quite different from what we had originally agreed upon.

Tufts College, November, 1944

GEORGE N. HALM

CONTENTS

INTERNATIONAL MONETARY COOPERATION

I.

INTRODUCTION

CHRONOLOGY

On April 7, 1943, the Secretary of the Treasury made public a *Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations.*[1] At the same time proposals by British experts for an *International Clearing Union* were released.[2] The American proposals are known as the *White Plan* after their main author Dr. Harry D. White, Director of Monetary Research of the Treasury Department. The British proposals are generally referred to as the *Keynes Plan.*

Both plans were considered as preliminary documents, tentative in character, which represented the viewpoints of technical experts and did not commit the respective governments to the principles or details of the schemes. They were intended purely as a basis for discussion, criticism, and constructive amendment.[3]

The opening guns of this discussion were fired in the parliamentary debates on post-war international currency in the House of Commons on May 12, and in the House of Lords on

1. The original version of the proposals for an International Stabilization Fund was published in the *New York Times,* April 7, 1943, and in the *Federal Reserve Bulletin,* June, 1943.

2. The proposals for an International Clearing Union (London H.M. Stationery Office, Cmd. 6437, April 7, 1943) were reprinted in the *Federal Reserve Bulletin,* June, 1943. The British Plan is distributed in the United States by the British Information Services, 30 Rockefeller Plaza, New York. See Appendix II of this volume.

3. See *Keynes Plan,* p. 2 of the reprint by British Information Services.

May 18, 1943.[4] Informal discussions were held in Washington in which the representatives of nearly thirty countries took part. On June 9, 1943, the Canadian experts submitted their suggestions in form of *Tentative Draft Proposals for an International Exchange Union.*[5] The United States Treasury included the suggestions of the representatives of other nations in a *Revised Draft* of July 10, 1943, but called the new version of the White Plan still a preliminary document.[6]

Parallel to these organized and semi-official discussions went a controversy in the form of articles, pamphlets, addresses and proceedings unmatched in other fields of post-war planning.

The publication of a *Joint Statement by Experts on the Establishment of an International Monetary Fund* on April 21, 1944,[7] brought the discussion to a preliminary conclusion. The Joint Statement contained the basic principles upon which the monetary experts of the United Nations have agreed. It was a compromise of the earlier proposals and followed in its broad outlines the approach which was originally suggested by Dr. White and supplemented by the Canadian experts. Though the Keynesian blueprint was not chosen as framework for the proposed international monetary organization, the compromise draft was, nevertheless, quite visibly influenced by Lord Keynes.

The Joint Statement was the result of discussions at the "technical level." Governments were not asked to give final approval until the principles would be embodied in the form

4. *Parliamentary Debates on an International Clearing Union.* Text of Speeches on the Proposals of British Experts, House of Commons May 12th, 1943, and House of Lords May 18th, 1943. British Information Services, New York, July, 1943.

5. *Tentative Draft Proposals of Canadian Experts for an International Exchange Union,* Ottawa, June 9, 1943. Distributed in the United States through the Canadian Wartime Information Board, Washington, D. C. This so-called *Canadian Plan* was reprinted in the *Federal Reserve Bulletin,* August, 1943.

6. *Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations.* Revised, July 10, 1943. Washington, D. C., United States Treasury. Reprinted in the *Federal Reserve Bulletin,* September, 1943. See Appendix I of this volume.

7. *New York Times,* April 22, 1944; *Federal Reserve Bulletin,* May, 1944. See Appendix III of this volume.

of definite proposals by the delegates of the United and Associated Nations in a formal conference. This conference was held in Bretton Woods, N. H., from July 1 to July 22, 1944. Delegates of forty-four nations attended and, on July 22, 1944, signed *Articles of Agreement of the International Monetary Fund*[8] which they will submit to their home governments for approval or rejection. The Agreement received a unanimous vote of acceptance subject to "general reservations" which are not mentioned in the final act but will be stated in the minutes of the Fund Commission.

At the same time and under the same conditions the delegates of the Bretton Woods conference signed *Articles of Agreement on the International Bank for Reconstruction and Development.*[9]

PURPOSE OF PRESENT STUDY

The present volume tries to summarize the whole controversy (which is quite unique in monetary history) and to evaluate its achievements. Main emphasis is, of course, given to the Articles of Agreement of an International Monetary Fund, which are a technical elaboration of the Joint Statement. The White and Canadian plans will be frequently referred to; but since they are now superseded by the Joint Statement and the Agreement they are not discussed at length to avoid tedious repetitions. A comparison of the Agreement with the Keynes Plan, on the other hand, will help substantially in the evaluation of the proposed International Monetary Fund.

OPPOSITION

For the better understanding of the International Monetary Fund we have also to become acquainted with the ideas of those who are opposed to the new plan.

8. *Articles of Agreement. International Monetary Fund and International Bank for Reconstruction and Development.* United Nations Monetary and Financial Conference, Bretton Woods, N. H., July 1 to 22, 1944. See also *New York Times,* July 23, 1944, and Appendix IV of this volume.

9. Cf. note 8; see *New York Times,* July 24, 1944, and Appendix V of this volume.

These critics can be divided, roughly, into two groups. They are, *first*, the friends of the gold standard who advocate an international payment system similar to the one which operated successfully prior to the first World War. They believe that the approach of the new plans is basically wrong. Instead of trying to create an international monetary organization, the different countries should put their own houses in order, balance their budgets and stabilize the internal value of their currencies. Once domestic monetary stability is achieved, international stability will follow more or less automatically and without any sacrifice of national sovereignty. On the other hand, if the national currencies are not stabilized, no international institution could possibly be successful in bringing about exchange stability.

The *second* group of critics opposes the new plans as too conservative. They want to eliminate gold altogether. Price stability is not considered desirable. The national economies should under no condition be put under deflationary pressure. Full employment should be achieved and maintained even if multilateral trade relations would have to be abandoned for the greater aim of domestic full employment equilibrium. An international monetary scheme is *a priori* suspicious to this group because it implies interference with national monetary and credit policies.

SOVEREIGNTY

But the extremes meet. Both the "hard money" advocates and the monetary nationalists who refuse to be put into the "strait jacket" of gold, share the belief that the new monetary plans are incompatible with national sovereignty, and both suffer from a misconception of the idea of national sovereignty. The friends of the gold standard fail to see that in playing the gold-standard game they would have to submit to rules which are more rigid than those of the proposed International Monetary Fund. And the advocates of strictest noninterference with domestic monetary and credit policies come dangerously close to those mistakes in which the inter-war period excelled.

It would be a poor concept of sovereignty which would lead

to the justification of such unilateral policies as, for example, exchange control, competitive exchange depreciation, or multiple currency devices but would prevent us from joining a multilateral payment system. If the essence of sovereignty is the right to enter into a contract in the international field, we are not losing sovereignty by exercising this right in joining an international monetary organization. But, of course, we shall have to watch out lest we undertake obligations which we are in no position to fulfill.[10]

PURPOSES OF AN INTERNATIONAL MONETARY ORGANIZATION

Fortunately our choice does not have to be one between the old gold standard and the discriminatory practices of the interwar period as the discussion of the new plans will show. Nor do we have to create a world currency. The new plans are not overambitious. We shall not carry in our pockets international currency which we could spend as legal tender in Fifth Avenue or in a jungle village. The newspaper headlines which at first emphasized the creation of an international monetary unit called "bancor" or "unitas" picked the least important feature of the original plans.[11] These names have now been dropped.

What the new schemes actually try to do is to project into the international field the principles of Central Banking which are generally accepted in the domestic field.

This is a development of convincing logic. But it has to overcome important obstacles. Being the banker for Central Banks, an International Monetary Fund will have to pool the resources of different monetary systems and coordinate the credit policies of nations—not simply of commercial banks.

The member countries of the proposed international monetary organization will not be forced into sudden and drastic adjustments at the price of rapidly increasing unemployment. Put under intolerable deflationary pressure, a country would

10. See A. F. Luxford, "Report of Proceedings at the Thirtieth National Foreign Trade Convention," in *Banking Sessions* (New York, October 25, 1943), p. 54.

11. Not to say the worst. The names were "rotten bad," Lord Keynes admitted.—*Parliamentary Debates*, p. 76.

simply refuse to cooperate in an international scheme and try again exchange control or competitive exchange depreciation. Thus it must be the objective of a plan for international monetary cooperation to prevent, as far as possible, the development of grave balance of payments disequilibria. And since disequilibria cannot be eliminated altogether, it must, next, be the purpose of an international monetary organization to see to it that adequate reserves of "international money" are put at the disposal of the member countries so that sufficient time is allowed for the necessary adjustments. Fundamental disequilibria, finally, will have to be corrected by an orderly and agreed method of exchange depreciation.

The member countries cannot, of course, be left entirely free to do as they please. To be a member of an international organization implies certain limitations on the domestic policies of the member countries. It will be impossible to fulfill the request of the Keynes Plan that "the plan should not wander from the international *terrain*" (*Keynes Plan*, Preface). But buffers and springs will be provided to make the interaction of the international mechanism and the national monetary and credit systems as smooth as possible and to prevent one-sided pressure on the deficit countries.

CREDITORS

To the reader of the new plans it may, at first, appear as if the schemes would ask too much of the prospective creditor countries. We shall have to examine this important point very carefully. (The Keynes Plan seems, indeed, to have fallen into the other extreme and to have replaced the deflationary bias of the old gold mechanism by an inflationary bias which rests on a philosophy of expansion and contains potential dangers; and even the Keynes Plan is not expansionist enough for many British observers.) But we shall see that the creation of an international organization is just as important for potential creditor countries as for potential debtors among the member states. According to the Canadian experts "it would be a distortion of the realities of the situation for any country, or its citizens, to regard the willingness to provide resources to an international

organization of the general character proposed by the British and American experts as an act of generosity which is performed for the sake of foreign countries. Resources are provided to the organization first, because all have a stake in re-creating a functioning international economic system and secondly, because for each individual country the realistic alternatives in the form of trade disorganization are costlier than the provision of resources." [12]

DIFFICULTIES AND MISCONCEPTIONS

The new proposals, as compromise solutions, pay for their eclectic attitude with complicated provisions. A compromise settles a dispute by mutual concession; it adjusts conflicting opinions by modification. It is, therefore, harder to compromise than to adhere to the simple formulae which are characteristic for extreme viewpoints. But the comparative simplicity of the intransigent attitude is often deceptive and merely due to incapability or unwillingness to see other people's or countries' viewpoints and problems.

The new plans are further complicated by the fact that they are so designed that they can be put into operation immediately after the war when the transition from war to peace will create many difficult problems. Thus the new schemes will seem rather complex to the average reader and it may be easy for those who have set their minds against a compromise solution to convince the public that the new plans, even in the form of the Agreement, are too ambitious, too complicated or, at least, premature.

The plans for international monetary cooperation are furthermore often discussed as if they were intended to solve the international economic post-war problems in their entirety. Again and again the proposals are objected to on the grounds that they are designed to finance relief and reconstruction—problems which are definitely beyond their scope.

The situation is, admittedly, very complex. As Secretary Morgenthau correctly stated: "monetary stabilization, commercial policy, the provisions of long-term international credit, promotion of stability in the price of primary products, and arrange-

12. *Canadian Plan,* General Observations, 8.

ments for relief and rehabilitation are problems that join at innumerable points." But he adds that "because of their complexity, they must be taken up separately, although each in turn must be integrated with the rest." [13]

A DEMOCRATIC SOLUTION

We should never for a moment lose sight of the fact that, with the extreme solutions being what they are, we must compromise and that, trying to establish the old gold standard rather than accept the Agreement we may find ourselves again saddled with exchange control and other discriminatory practices. Those, on the other hand, who dare not make the slightest concession in their national monetary and credit policies should be careful lest their system loses every trace of exchange stability and multilateralism.

The following pages are intended to support and to recommend the Agreement as a fine, well-balanced document which is moderate and progressive at the same time and whose position in the very center of widely differing viewpoints should be acceptable to all but the most extreme.

Nobody will agree with every detail of a compromise and many may be our misgivings. But somehow we have to tackle the difficult problem of international monetary cooperation, which simply cannot be left alone, especially in the immediate post-war period.

Concerted effort, good will, and the democratic process by which the Agreement has been arrived at are in themselves already a great accomplishment. And since this is a kind of a test case it would be a sorry anticlimax to the winning of the war if the whole effort towards international monetary cooperation should lead to nothing. On the other hand, "if such programs can be put into operation before the end of the war, we will save much time in the task of bringing about domestic and world-wide prosperity when hostilities cease and immeasurably strengthen the prospects for an enduring peace." [14]

13. Foreword to *White Plan.*

14. Secretary Hull, commenting on the Joint Statement, *New York Times,* April 23, 1944, p. 1.

II.

THE GOLD STANDARD MECHANISM

HOW THE GOLD STANDARD MECHANISM WORKS

It is best to begin a discussion of the International Monetary Fund proposals with a recapitulation of the gold standard mechanism. *First,* because the gold standard mechanism was the world's nearest approach to a system of international monetary equilibrium; *second,* because a return to the old gold standard game is asked for by conservative writers; *third,* because a modernized gold standard plan may compete for adoption; *fourth,* because the new plans contain essential features of the old gold mechanism; and *fifth,* because part of the design of the new plans is to be understood as an attempt to eliminate basic deficiencies of the old price-specie flow mechanism.

The gold standard game presupposes that the "member countries" are "on gold." Their monetary authorities are willing to buy and to sell gold at a fixed price in unlimited amounts. The national monetary units are defined in terms of weight units of gold, and through the medium of gold the exchange rates are fixed. Under these conditions gold is the world's common unit of value, an international means of payment, and a money reserve of international liquidity.

The gold standard mechanism works supposedly as follows: Assume that a country's purchases of commodities, services, and securities from other countries are not exactly offset by similar but opposite transactions. This country's increased demand for foreign currencies raises the price of these currencies in terms of the country's monetary unit. The immediate effect will be the same on which a system of free or flexible exchanges would

rely exclusively: exports will be stimulated and imports will be reduced. But exchange rates are allowed to fluctuate only within very narrow limits. When the so-called gold export point is reached, the supply of foreign balances becomes completely elastic because the "currencies of any two gold standard countries are convertible into one another at no greater cost than is involved in sending gold from one country to the other." [1] Since the Treasury or the Central Bank at home and abroad are willing to sell and to buy gold in unlimited amounts, the exchange rates are stabilized as long as the gold reserves of the deficit country last. But, sooner or later, international payment equilibrium must be restored to prevent exhaustion of the deficit country's gold reserve.

The restoration of international payment equilibrium is supposed to be automatically accomplished through the effects of the gold flow upon the economies of both the gold-losing and the gold-receiving countries. In the gold-losing countries the contraction of the monetary circulation will reduce income and expenditure. Prices and wages will have a tendency to fall while increasing rates of interest will attract short-term funds from abroad. Similar but opposite effects are to be anticipated in the gold-receiving countries. The necessary adjustments may take place promptly and smoothly through changes in prices, wages, and interest rates, or they may be painful and connected with a sharp decrease in the national income of the gold-losing country, with increasing unemployment and with a general decline in the volume of international trade. We shall, first, make the "textbook" assumption of a smoothly working mechanism and, then, proceed to criticize this oversimplified picture.

GOLD OUTFLOW AND CREDIT CONTRACTION

The gold flow affects directly the reserves of the commercial banks and, therefore, their ability to extend loans to their customers. We assume that the commercial banks are required by law (or, as in England, by custom) to hold a reserve of, say, ten per cent of their customers' demand deposits (check ac-

1. See R. G. Hawtrey, *Trade Depression and the Way Out* (London, Longmans, Green & Co., 1931), p. 11.

counts) in form of a reserve deposit with their Central Bank; in turn the Central Bank is required to have a gold reserve of some thirty-three per cent of the commercial banks' reserve deposits. We assume, furthermore, that the Central Bank is the gold-buying and gold-selling authority. Now if gold is bought by gold arbitrageurs [2] for export purposes, the amount of purchasing power in the economy may possibly be decreased by thirty times the value of the exported gold. For in case that neither the Central Bank nor the commercial banks had excess reserves at their disposal, every "dollar" gold outflow would force the Central Bank to reduce the commercial banks' reserve deposits by three "dollars" and the commercial banks to reduce their customers' loans and deposits by thirty "dollars." While this is, of course, an extreme case, it indicates the possible multiple credit contraction which a gold outflow may cause.

The automatic effect of the gold outflow is limited to the reduction of the gold buyer's deposit and an equal reduction of his bank's reserve. Since the commercial banks, in our example, need only hold a ten per cent reserve against their demand deposits, the bank's reserve position is weakened. Whether it has to contract its loans depends on its excess reserves or on its ability to borrow additional funds from the Central Bank; and whether the Central Bank is willing and able to extend credit to the commercial bank depends again on the Central Bank's gold reserve.

Hence we see that in a modern banking system no definite predictions can be made as to the actual effect of an outflow of gold upon the total credit structure, but the chances are that the more prolonged the loss of gold, the more drastic the credit contraction would have to be.

GOLD INFLOW AND CREDIT EXPANSION

Exactly the opposite effect is to be expected in the gold-receiving country. In this case the purchase price of gold bought by the Central Bank is added to the seller's deposit account as

2. An arbitrageur buys a commodity in a place where it is cheap in order to make a profit by selling it in another place at a higher price.

well as to his bank's reserve deposit in the Central Bank. Excess reserves are created and the Central Bank, which finds itself in the possession of additional gold, can and should increase the deposit accounts of the commercial banks still further either through open market purchases or through the discounting of commercial paper.

These expansionist policies which depend, as we notice, at least partly on a conscious effort on the part of the Central Bank, will reduce the rates of interest in the gold receiving country; while, on the other hand, the rates of interest in the deficit or gold losing country will rise owing to its policy of credit contraction. The different interest levels will, therefore, cause a flow of short-term funds from the gold-receiving to the gold-losing country. This flow of short-term capital will supply foreign balances for, and ease the deflationist strain in, the deficit country. Such an adjusting movement is extremely important for the smooth working of the gold standard mechanism.

But, as long as the price level of a country is out of line with the price levels of the other member countries, the basic and long-run adjustment is to come from changes in the respective price levels which the reciprocal policies of credit contraction and credit expansion are supposed to bring about. The gold-losing country will reduce its price-cost structure, will export more and import less, and, with opposite adjustments in the gold-receiving countries, international payment equilibrium is basically restored—not simply patched up.

ESSENTIAL CONDITIONS

The functioning of the gold standard mechanism, in attaining international payment equilibrium, presupposes the fulfillment of several essential conditions. The monetary authorities of the member countries must, above all, be willing and able to play the gold standard game according to its rules, even if to do so interferes with the aims of domestic credit policy. It is not at all impossible that the actions required by the gold standard game will conflict with measures designed to reach or to maintain full employment. Another important condition is a sufficient flexi-

bility of the cost-price structure of the member countries. Prices and costs, particularly wages, must be adjustable both upwards and downwards. Protectionist policies are compatible with the working of the gold standard mechanism as long as they are not meant to interfere expressly with its working as when, for instance, a country calls in foreign loans and raises its tariffs simultaneously. That a country which has to make payments on capital account must be enabled to do so by a favorable balance of trade on income account goes without saying.

Generally speaking the mechanism may work satisfactorily in normal times when only modest disequilibria are to be adjusted. But the mechanism breaks down if the deflationary policies prescribed by the rules of the game turn out to be politically and socially unbearable. The gold standard mechanism is a fair-weather craft, of doubtful seaworthiness in stormy waters. In its defense we may point out, however, that the mechanism is designed and intended to maintain normal conditions and to correct disequilibria automatically at such an early stage that really dangerous situations will not arise.

ADVANTAGES OF THE GOLD STANDARD MECHANISM

The advantages of the gold standard mechanism may briefly be summarized as follows:

(1) The gold standard mechanism guarantees stable exchange rates (with only minor variations) between the member currencies as a reliable foundation for international trade and international capital movements.

(2) The gold standard mechanism uses small and early-applied doses of inflation and deflation in hopes of avoiding deflations and inflations of the more violent and self-propelling type.

(3) The different countries are kept in line with the average behavior of other gold standard countries without having to submit to controls by an international authority.

(4) Reserves of international liquidity (gold reserves) are provided as shock absorbers. Necessary adjustments do not have to be carried out hastily. The mechanism is so designed that, while gold outflow decreases the reserves, it tends at the

same time to replenish the reserves automatically through capital inflow and export surpluses.

(5) The gold mechanism works semi-automatically, is not complicated, and requires very few restrictions. Since the rules of the game are well known to all players, the actions of the monetary authorities are foreseeable—a fact which introduces a further element of security into international relations.

(6) The gold mechanism makes use of a public prejudice in favor of gold. However mistaken this prejudice concerning the "intrinsic" value of money or the "backing" of money may be, it is one of those cases where an evil, if it cannot be exorcized, may be used with advantage for a worthy purpose.

In spite of these advantages the gold mechanism has little chance of being reintroduced in its old-fashioned form. This is partly due to experiences during the inter-war period when the gold standard came back to a short and troubled life. We can, of course, argue that the gold standard was not to blame because it had been revived at a time when the countries of the world were not willing to play the game according to accepted rules and to fulfill the necessary conditions. But in going back to gold the countries had indicated their willingness to stick to the rules, and that they were unable to do so points to some more basic difficulties rather than plain misbehavior.

THE BANKING ANALOGY

The gold standard mechanism has one fundamental defect which can only be overcome in a consciously organized international system. An analogy will help to clarify the point in question. The member countries in a gold standard system can be likened to the commercial banks in a national banking system. Just as gold outflow and gold inflow keep the gold standard countries on an even keel, so are the commercial banks of a national credit system kept in line by the outflow and inflow of cash. But while the commercial banks are members of a system which follow the leadership of, and are controlled by, a Central Bank, no such controlling leadership exists (at least theoretically) in the price-specie flow mechanism. If all the member countries simultaneously follow an inflationary policy, they are

not stopped by an International Reserve Bank for the reason that no such bank exists in the gold standard mechanism. World-wide inflationary tendencies, it is true, are supposed to decrease gold production since the price of gold is fixed while the cost of gold production increases with a general price rise. But this reaction is much too clumsy and means little anyhow in a modern credit system where changes in reserve requirements can easily compensate for a shortage (or abundance) of gold as long as simultaneous changes take place in all the countries concerned. World-wide inflationary or deflationary tendencies can, therefore, be expected under the gold standard and these tendencies would be purely accidental. Thus, while the member banks of a banking system may be kept in check by the Central Bank if they, together, tend to overexpand, no such authority has been available to keep the member countries of a gold standard system under deliberate control.

The comparison of member banks and "member" countries is more than an analogy. It is one and the same problem in its domestic and in its international aspects. Nationally, the commercial banks are led by their respective Central Banks; internationally, the Central Banks are merely following "rules of the game" without conscious leadership, unless such leadership is provided by sheer predominance of one creditor nation. The rules of the game amount to following blindly and passively the average behavior of the group (or the behavior of the leadership country). This situation was considered tolerable or even desirable before 1914 when England was predominant as the world banker. Since then, the national governments have learned to look at their credit and government spending policies as indispensable weapons of economic policy, and it has, therefore, become increasingly impractical that these policies should be subjected to trends of average behavior which are either entirely accidental or else dictated by one country.

This attitude was the main reason for the fact that the world-wide revival of the gold standard mechanism around 1925 was not successful. Following their own—often misconceived and short-sighted—ideas of a national credit policy instead of following the rules of the gold standard game, the nations of

the world began to pull away from one another and to strain the unifying mechanism to the breaking point. This basic difficulty must be understood because it will be with us after this war even if the more superficial difficulties of the transition period have been overcome.

INTEGRATION OF NATIONAL CREDIT POLICIES REQUIRED

If the national governments can no longer be expected to follow blindly the vagaries of average behavior and if independent nationalistic policies put the old gold standard system under unbearable strain, it is only logical to conclude that the national policies will have to be integrated by an international institution. The friends of the old gold standard system make the mistake of assuming that the monetary authorities of the future can be expected to follow the rules of the game, and that the accidents of gold production or "average" credit policies will be accepted as guides for a domestic credit policy which may well consider employment problems as more important than stable exchange rates.

R. G. Hawtrey calls the gold standard mechanism a state of "anarchy in world credit control."[3] He is not at all sure that the actions taken by all the Central Banks will neutralize each other. They might as well lead to a world-wide vicious circle of contraction or expansion. If contraction prevails in a number of countries while the rest of the world is still free from it, the chances are that the diminishing purchasing power of the contraction-countries will soon affect the rest. And, in a similar manner but with opposite effect, the vicious circle of inflation is equally likely to develop. "Merchants and dealers are encouraged to borrow and therefore to buy. Production in all exporting countries is stimulated, and they expand credit and expand incomes so as to attract equivalent imports."[4] There is nothing in the gold mechanism itself which would prevent such a world-wide expansion or contraction. It is true that inflationary tend-

3. *Op. cit.*, pp. 15-18. See also T. Balogh, "The Currency Plans and International Economic Relations," *Political Quarterly*, Oct.-Dec. 1943, pp. 343-44.

4. *Op. cit.*, p. 17.

encies in any one country are supposed to lead to an outflow of gold. But, if profits are expected to rise, capital may be attracted to such a degree that gold may actually flow into the country and cause a further credit expansion.[5]

Joan Robinson suggests that the gold standard mechanism suffers from an "inherent bias towards deflation."[6] In other words, the mechanism is not symmetrical. The gold-losing country must contract credit in order to maintain its gold reserves unless it is willing to go "off gold." The gold-receiving country, on the other hand, is under no equal compulsion to expand credit in order to check the gold inflow.

To strengthen Mrs. Robinson's argument, and to return to our analogy, we should remember that the Central Banks have, as a rule, more power to force their member banks into credit contraction than to force them to expand. A Central Bank "can not insure demand for member bank credit; it can and does insure the availability of ample member bank credit when and if demand exists."[7]

Professor Williams suggests two more reasons for the one-sidedly deflationist working of the gold standard. "One is the unequal importance of the balance of payments as between countries whose foreign trade and other payments are large relative to the home economy and countries for which foreign trade is less important. The other is the unequal size of countries. Gold standard theory was based on the principle of interaction between homogeneous countries of approximately equal size." Referring in particular to the United States Professor Williams points out that "a large export surplus, or any other

5. See John H. Williams, "The Adequacy of Existing Currency Mechanisms under Varying Circumstances," *American Economic Review,* March, 1937, Supplement, p. 154. See also John H. Williams, "The Postwar Monetary Plans," *American Economic Review,* March, 1944, Supplement, p. 373: "Under modern conditions the gold standard has frequently not been the efficient instrument of two-sided compensatory international adjustment it was meant to be. It has been a means of spreading depressions, and sometimes booms, from one country to another."

6. See Joan Robinson, "The International Currency Proposals," *Economic Journal,* June-September, 1943, p. 161.

7. See *The Federal Reserve System—Its Purposes and Functions* (Washington, 1939), p. 58.

change leading to substantial gold inflow, would be likely to have a far less expansive effect here than contractive effect upon the deficit countries." [8]

Deflation is a dangerous medicine. It may start a vicious circle downward, especially if the price-cost structure of the country is not flexible. The classical version of the price-specie flow theory assumes that when gold flows out prices will fall like water in a lock. In reality, however, these changes are as a rule not achieved instantly and without grave frictions. To decrease imports is desirable from the standpoint of the gold losing country's foreign trade equilibrium. But it also means "that countries formerly balanced are thrown into disequilibrium and have to join in the process of deflation." Deflation, furthermore, "reduces not only imports but also consumption of home produced goods." [9]

Lord Keynes complains that the gold standard confines the natural tendency of wages to rise beyond the limits set by the volume of money, but can do so only in deliberately creating unemployment. He adds, however, that "this complaint may be just as valid against a new standard which aims at providing the quantity of money appropriate to stable prices." [10]

It is obvious that under these conditions Lord Keynes does not insist on rigidly stable exchange rates. On the contrary, the gold standard is expressly criticized because it involves a financial policy which compels the internal value of the domestic currency to conform to an external value which is rigidly tied to a fixed quantity of gold.

Lord Keynes proposes that "instead of maintaining the principle that the internal value of a national currency should conform to a prescribed *de jure* external value" we should provide "that its external value should be altered if necessary so as to conform to whatever *de facto* internal value results from domestic policies." [11]

8. See "The Postwar Monetary Plans," *loc. cit.*, pp. 374-75.

9. See Robinson, *op. cit.*, p. 162.

10. Lord Keynes, "The Objective of International Price Stability," *Economic Journal*, June-September, 1943, pp. 185-87.

11. Speech by Lord Keynes on the International Monetary Fund Debate, House of Lords, May 23, 1944.

DEFECTS OF THE GOLD STANDARD MECHANISM

Thus we see that the old gold standard mechanism suffered from grave defects. We can summarize the disadvantages as follows:

(1) The old gold standard mechanism amounts to "anarchy in world credit control" but forces the national monetary authorities, nevertheless, to subject their domestic credit policies to international dictation.

(2) The scope for independent domestic action is extremely narrow. Exchange rates are stabilized at the expense of giving up all other possible aims of monetary management such as economic stabilization and full employment.

(3) The gold standard mechanism becomes an anachronism at a time when monetary conditions and monetary policy are "recognized as too important and too close to the heart of fiscal sovereignty to be entrusted to any automatic or even semi-automatic system." [12]

(4) The price-cost structures of modern economies are not flexible enough for smooth downward adjustments. Deflationary policies are liable to lead to unemployment and the ensuing depression is consequently transmitted to other countries through decreasing imports.

(5) The mechanism itself rests more heavily on deflationary than inflationary credit policies. While the gold-losing country must contract credit in order to protect its reserves, the gold-receiving countries are not, necessarily, forced to follow a policy of expansion should they care not to play the "rules of the game."

(6) The "automatic" character of the gold mechanism should not be overstressed. Credit contractions or expansions are potentially dangerous. They require careful attention. On the other hand, the Central Banks may not be able, even though willing, to lower costs and prices sufficiently in case of credit contraction or to create enough demand for new loans in case

12. See Robert B. Bryce, "Basic Issues in Postwar International Economic Relations," *American Economic Review*, March, 1942, Supplement, p. 178.

of credit expansion. "In the modern world, where, on the one hand, inflows of gold are liable to be sterilised and prevented from causing an expansion of credit, whilst on the other hand the deflation of credit set up elsewhere is prevented by social causes from transmitting its full effect to money-wages and other costs, it may be that the whole machine will crack before the reaction back to equilibrium has been brought about." [13]

WHY THE GOLD STANDARD MECHANISM WORKED BEFORE 1914

Considering these grave defects we may well ask ourselves why the gold standard mechanism worked so well during the prosperous period preceding the first World War and why its performance was so poor during the later 'twenties? The explanation can be found in the fact that the two periods fulfilled the conditions essential for a healthy gold standard system to a very different degree.

Professor Hansen suggests that the successful functioning of the pre-1914 gold standard was "greatly facilitated by the circumstance that it operated in a rapidly expanding economy and under the favorable condition of an upward trend in prices." In other words, the deflationary bias of the system was overcompensated by world-wide credit expansion. "Maladjustments," says Professor Hansen, "can more easily be corrected in a society which is rapidly reaching out into new areas, developing new resources, creating new industries, and supplying the growing needs of an increasing population." Prior to the first World War we could, furthermore, assume "that the wage rates in each country would quickly become adjusted to productivity in conformity with the principle of comparative advantage." [14]

To this we may add that the gold mechanism was, until 1914, never put to a really severe test. Major international disruptions were absent, the price-cost structures of the different countries were in conformity with the exchange rates, and international capital movements served mainly to put sufficient reserves at

13. See *Committee on Finance and Industry Report* (*Macmillan*) (London, H.M. Stationery Office, 1931), p. 108. Hereafter cited as *Macmillan Report*.

14. A. H. Hansen, *Full Recovery or Stagnation?* (New York, W. W. Norton, 1938), pp. 210, 212.

the disposal of those countries which were, at the moment, in need of it.

Central Banks had no other ambition than to work, with often inadequate means, for domestic as well as international liquidity. The deflationary danger in this craving for liquidity was lessened, however, by a worldwide simultaneous development of modern credit instruments which made the gold standard system increasingly independent of the monetary gold supply.

WHY THE OLD GOLD STANDARD MECHANISM WILL NEVER RETURN

This heyday of the gold standard system will never return. Even assuming that the temporary difficulties of the transition period from war to peace were overcome, it is doubtful that "the contemporary economic climate" would be conducive to the old fashioned gold standard. Monetary policies are now considered integral parts of an economic policy which aims, first of all, at domestic economic stabilization and at stable exchange rates only because fluctuating exchange rates would endanger domestic stability. The Board of Governors of the Federal Reserve System, for instance, declares that the monetary objective should be economic stability rather than price stability and "that economic stability cannot be achieved by monetary policy alone, but that the goal should be sought through coordination of monetary and other major policies of the Government which influence business activity, including particularly policies with respect to taxation, expenditures, lending, foreign trade, agriculture and labor." [15] This is, indeed, a far cry from the typical attitude of a Central Bank under the old gold standard system.

The friends of the old gold standard could, of course, answer that the attitude of the Board of Governors is basically wrong and that it constitutes the very interference which is alien to the capitalist exchange economy. Unbridled capitalism, based on the profit motive, they feel, would also recreate those favorable conditions of rapid economic expansion which characterized the end of the nineteenth and the beginning of the twentieth century.

15. See *Federal Reserve Bulletin,* September, 1937, p. 828.

But these are questions of economic *Weltanschauung,* which cannot be decided on purely economic grounds. However, in saying that there is no road back to the old gold standard we do not necessarily express a preference for a greatly increased amount of government interference with private business. The new plans for international monetary cooperation in fact are, as we shall see, quite obviously designed to do away with the worst forms of interference in international economic relations. That the nations of the world should submit their domestic credit policies to international forces only when these forces are deliberately controlled may perhaps violate the principle of *laissez faire.* But conscious international control is only the logical and consistent projection into the international field of sound principles of money and banking which nobody would brand as fetters of private enterprise when they are applied to the domestic field.

III.

THE LESSONS OF THE INTER-WAR PERIOD

INFLATION AND DEFLATION

THE CHAOS in international monetary relations during the inter-war period cannot be used as an argument for the gold standard. These chaotic conditions were certainly not caused by the fact that most countries had gone off the gold standard. On the contrary, the gold standard mechanism had broken down under the first impact of the storm. Rather the chaos was due to the first World War and the complete absence of concerted international effort to solve the monetary problems of its aftermath. This failure, in turn, resulted from the nationalist and isolationist ideologies throughout the world. Since we are determined not to repeat the mistakes of the inter-war period, we should recapitulate the outstanding problems which we failed to solve.

A detailed historical description is not required for this purpose. It will suffice to enumerate the essential errors made and to indicate ways and means by which similar mistakes in the post-war period to come can be avoided.

The inter-war period was characterized by violent changes in the purchasing power of most of the world's currencies. The most outstanding case was, of course, the depreciation of the German mark to one trillionth of its original value. But all the countries of the world went through periods of inflation and deflation and at such different times and in such different degrees that international exchange stabilization was quite impossible.

Much could be said about the German experiences during the hyper-inflation of the mark (1920-1923) which gravely

shook the social structure of Germany and dispossessed the lower middle class from which Adolf Hitler was to recruit his earliest and most ardent followers. But the causes of the German inflation are fairly obvious and need not be restated. More dangerous for the success of post-war monetary stabilization are the less overt, the "hidden" forms of inflation which may even take place at a stable price level.

An inflation is not easily defined. The notion that inflation means an increase and deflation a decrease in the general level of prices is not always helpful. It oversimplifies the issue and may lead to mistaken policies. It is understood that with growing employment and production the monetary circulation has to expand if prices are to be prevented from falling. But this credit expansion has, in other respects, the characteristics of inflation. It stimulates demand, reduces the rates of interest and induces, other things remaining equal, investment. Every prosperity period has in this sense an inflationary basis.

Turning to the problem of deflation, it is quite obvious that deflation, if defined as a decrease in the general level of prices, might be harmless as long as technological improvements have lowered the cost of production in many industries; however, it might be very dangerous if an attempt is made by the monetary authority to force prices down through credit contraction. This latter type of deflation reduces demand, production, and employment.

Stable prices are, therefore, not a safe criterion for monetary policy.

An attempt has been made, by some monetary theorists, to replace the popular concepts of inflation and deflation by the concepts of "relative" inflation and "relative" deflation. According to these concepts, money would be "neutral" if its quantity were kept approximately stable and corrected only for changes in its velocity of circulation, and other carefully defined eventualities.

But a stable quantity of money should not be used as an alternative criterion for monetary policy. To propose, for instance, that monetary circulation should not be increased and credit should not be expanded, during a period of stagnation,

is an absurdity. On the other hand we should not be led to believe that everything is all right as long as prices are stable and unemployed resources, especially labor, are still available. We must not forget that, with the approach of full employment, credit expansion would have to be abandoned unless the more dangerous price inflation is to be started, and that the more or less sudden interruption of credit expansion may easily turn an upswing into depression.

These somewhat more refined considerations concerning inflation and deflation will be helpful for the better understanding of the monetary phenomena of the inter-war period and for the better appreciation of the post-war stabilization proposals.

OVERVALUATION IN GREAT BRITAIN

The stormy sea of inflationary and deflationary waves had calmed down by 1925 to what seemed to be a reasonably stable international level. A general return to the gold standard was undertaken. But the new gold standard mechanism started with a very serious defect in its machinery. The all-important gold parities had been chosen on the basis of what Professor Robbins correctly describes as hit-or-miss methods.[1] Unfortunately two of the most important parities, the English and the French, were misses and not even near misses at that. As a result the pound was overvalued and the franc was undervalued.

To understand the full implications of these facts we have to remember that the rates of exchange should be determined *approximately* by the so-called purchasing power parities: [2] that is, the relationships between the countries' respective domestic price levels. For example, if the price level in England had risen relative to that in the United States, the foreign value of the pound in terms of dollars should have fallen roughly in proportion to the decline of the pound's domestic purchasing power. Though the prices in England had risen further than the prices in the United States, a balanced international trade between the two countries would still have been possible provided only that,

1. Lionel Robbins, *The Great Depression* (London, Macmillan, 1935), p. 9.
2. See, however, below, Chapter X, pp. 127-30.

other things remaining equal, the pound could be bought at a correspondingly lower dollar price. But, by insisting on the old, pre-war, sterling-dollar exchange, England put herself unnecessarily into a most difficult and even dangerous position.

This rate could only be maintained if England deflated, or if the United States inflated, or if a concerted effort in both countries established a purchasing power par commensurate with England's willfully established pre-war gold parity.

England's gold parity put her export industries at an artificial disadvantage at a time when her export trade was in a most difficult position owing to the disruption of her foreign markets and other structural changes as a result of the war. The attempt towards deflation proved unsuccessful. Once again it was realized that "pressure can be brought to bear upon the users of credit by a restriction of credit or the raising of bank rate, but that pressure cannot be directly brought to bear upon the costs of production."[3] The wage and price structure was too rigid, and the whole effort deteriorated into seemingly permanent stagnation.

England's situation during the gold standard period from spring 1925 to fall 1931 was especially embarrassing in view of her leading position on the international capital market. Chronic export difficulties made long-term capital export (which depends on commodity exports) very difficult while the constant danger of gold outflow and correspondingly high money rates attracted short-term funds—"a lack of balance between long-term and short-term investment which was itself conducive to disequilibrium and latent with danger of extensive catastrophe."[4]

CHEAP MONEY IN U.S.A.

While England suffered from stagnation and unemployment, the inflationist cheap-money policy in the United States around 1927 led to seemingly much better results. The price level in the United States, it is true, did not rise very much nor was England's problem solved by the expansionist policy of the

3. *Macmillan Report*, p. 22.
4. Robbins, *op. cit.*, p. 9.

United States. But for several years the United States enjoyed an unexampled prosperity. The final consequences of this gigantic cheap money experiment are well known. Credit creation increased expenditure, investment, employment, and output in a self-propelling process. But finally investment increased to a point where profits had to decrease while, with the approach of full employment, credit expansion had to be stopped to prevent price inflation. Decreasing profits and increasing rates of interest initiated a vicious downward spiral in which decreasing investment caused unemployment and unemployment in turn caused a further decrease in consumption and investment.

Considering these events the British Committee on Finance and Industry, appointed by the Chancellor of the Exchequer under the chairmanship of H. P. Macmillan, and counting among its members J. M. Keynes, came, in its famous report (Macmillan Report), to the following conclusion:

Control of credit conditions is always easier before a boom has commenced in earnest. When that has once happened, to prevent its development to a stage ultimately leading to a reaction, and to prevent the reaction running its full course, are both difficult. Yet a Central Bank, if it attempts to curb an upward movement, may and will be criticised for cutting short the country's nascent prosperity. Even when the recent American boom had grown to very great proportions, there was strenuous and widespread opposition in every quarter, even the most authoritative, to any attempt seriously to control it. To the difficulties of the control by a Central Bank of its own market must be added the additional difficulty of securing concerted action by several. Even if it were conceded that such concerted action would generally be effective if it were taken soon enough, it may be argued that it is not in fact practicable to detect and interpret the obscure premonitory signs of the financial weather soon enough or accurately enough, or with a high enough degree of probability, to procure concerted action amongst a number of independent authorities, each of which is likely to have its own ideas based on its local information and to maintain them with tenacity. Here again only time can show. There is no need to minimise the difficulty of the high enterprise which we should like to see the Central Banks of the world put in hand.[5]

5. *Macmillan Report,* p. 131.

The Macmillan Report was published in June, 1931 (shortly before the devaluation of the pound). It arrived at very interesting "proposals relating to international monetary policy."[6] Since the conclusions of the Macmillan Report deserve the most careful consideration in the present debate about the same question, they are quoted at some length as follows:

(i) The aim of the Central Banks should be to maintain the stability of international prices both over long periods and over short periods....
(ii) The method of achieving this objective should be so to regulate the volume and terms of bank credit as to maintain as much stability as possible in the rate of new investment and new enterprise generally, both at home and abroad. By these means alternate excesses of enthusiasm and depression might be avoided and the demand for new output of the instruments of production and other forms of capital in the world at large kept in better equilibrium with the proportion of income which is currently available for such purposes—neither in excess nor in defect.
(iii) With this end in view the Central Banks should confer together at frequent intervals to decide whether the general tendency of their individual policies should be towards a relaxation or a tightening of the conditions of credit; and their bank rates and other instruments of credit control should then be adjusted accordingly, without prejudice to their policies relative to one another remaining at the free discretion of each separate institution. Nor should they be afraid of small and frequent changes. For otherwise action may be unduly deferred....
(iv) This form of joint policy should be consistent with a full measure of autonomy for each national institution. In particular, each Central Bank should remain free to attract gold to itself whenever it *deliberately* desired to do so, without incurring blame or exciting complaint from the other Central Banks; ... and also to raise its own bank rate for the sake of checking inflationary tendencies at home, even if the tendencies abroad were of a contrary character.
(v) But each Central Bank should undertake to do its best to avoid the importation of unwanted and unnecessary gold merely as a result of leaving natural forces to work themselves out unchecked. It should be the duty of each bank to avoid an unbalanced interna-

6. *Ibid.*, Part II, Chapter II.

tional position which was the result of accidental circumstances or the unintended repercussion abroad of its domestic policy. In particular, if the effect abroad of a curtailment of credit, intended merely to counteract a domestic inflationary tendency, was unintentionally to attract gold, there is a presumption that this effect should be offset by the Central Bank in question being prepared to increase its own balances elsewhere.

(vi) In particular, Central Banks should consider the rate of long-term investment as well as short-term investment as falling within their purview, and should take whatever steps may lie within their power, and are suited to their local circumstances, to counteract any tendency which their own nationals may show either to keep their investible resources excessively liquid or to undertake excessive long-term commitments.[7]

It is interesting to note that the fear of inflation seems to prevail in these conclusions despite the fact that the Macmillan Report was written at the end of England's deflation ordeal and before she had cut herself loose from gold. The cheap money experiment in the United States, and its consequences, obviously made a deep impression upon most members of the Committee. The Report gave the advice that England should not cut herself loose from the international system, because of momentary domestic advantages, since "there can be little or no hope of progress at an early date for the monetary system of the world as a whole, except as the result of a process of evolution starting from the historic gold standard." [8]

"RECKLESS BORROWING AND LENDING"

To understand the Committee's fear concerning unbalancing gold and capital movements, we have to remember that the international credit crisis at the time of the *Macmillan Report*

7. *Ibid.*, pp. 131-33.

8. *Ibid.*, p. 109. The quotation continues: "If, therefore, this country were to cut adrift from the international system with the object of setting up a local standard with a sole regard to our domestic situation, we should be abandoning the larger problem—the solution of which is certainly necessary to a satisfactory solution of the purely domestic problem. . . ."

had been caused by what Cordell Hull branded as "reckless international borrowing and lending."[9] This policy of borrowing and lending was reckless because it was coupled with inconsistent economic policies in both the debtor and the creditor countries. While Germany borrowed foreign capital, partly in the dangerous short-term form, she spent the funds rather lavishly on public works of an unproductive character and transferred her reparation payments by means of the borrowed foreign money. The test for the economic effects of reparation payments came not immediately after the German mark stabilization in 1923 but six years later when the stream of foreign loans dried up. Then it could be seen that one-sided payments from one country to another can only be made if the receiving country is willing to accept the payments in the form of commodities and services. That the main creditor countries tried to exclude the commodities of the debtor countries through protectionist devices is one of the most glaring inconsistencies of the inter-war period. The creditor countries had the duty either to purchase additional imports or else to use their receipts to make long-term loans (or to convert short-term into long-term loans). By failing to act consistently the creditor countries drove the debtor countries into deflation, devaluation, and exchange control.

DEVALUATION AND RECOVERY IN ENGLAND

While Germany as well as the United States suffered from deflation, England experienced a moderate recovery after the devaluation of the pound in September, 1931.

Devaluation can be highly successful under fortuitous circumstances and the circumstances were highly fortuitous for England in 1931. England had a head start in the process of competitive depreciation, and she was not followed for several years by the most important gold standard countries. "Thus, England achieved the best of two worlds: (1) an export advantage over competitors, and (2) an improvement of trade through exchange stability with countries complementary to

9. Before the Committee on Ways and Means, January 11, 1940.—*New York Times,* January 12, 1940.

her economy."[10] These "complementary" countries were the sterling-bloc countries which had simultaneously depreciated their currencies under the leadership of London.

Nevertheless, the Macmillan Report had been right in its warnings. However impressive the momentary advantages, they were dearly paid for in the long run by the deterioration of international trade which had to follow inevitably. The advantage gained over the gold standard countries belongs very definitely in the category of *sauve-qui-peut* policies and could, of course, be only temporary.

This brief sketch of Great Britain's competitive exchange depreciation should not be concluded, however, without mentioning the creation of the British Exchange Equalisation Account on April 12, 1932, which was established to offset speculative movements in sterling exchange rates. This constructive achievement marks the beginning of a development which has now led to the proposal for an International Monetary Fund.

France is another example typifying inconsistent national policies. Her former relative undervaluation of the franc was now, in relation to the depreciated currencies of the sterling-bloc countries, an overvaluation. To stick to the gold standard, only so recently re-adopted, France had to practice deflation but at the same time was not willing to carry through commensurate labor policies. Caught between the desire to maintain the gold standard and to maintain, if not to increase, her wage level, France specialized in the newfangled protectionist device of import quotas.

DEVALUATION AND GOLD INFLOW IN U.S.A.

The United States devalued the dollar in 1933-34 probably under the assumption that the increase of the price of gold would automatically raise the domestic price level. The depreciation of the dollar had, indeed, the effect of expanding exports and of raising the dollar price of export goods thus causing a shift of income from people in general to farmers. This effect, however, could only be limited. The domestic prices depend

10. A. H. Hansen, *Fiscal Policy and Business Cycles* (New York, W. W. Norton, 1941) p. 99.

on demand and supply conditions, and, therefore, only an increase of demand through credit expansion could successfully raise the domestic price level. But while the monetary authorities can expand member bank reserves "they have no power to compel an expansion of member bank credit." [11] If the initiative is not taken by businessmen, then it seems obvious that only a government spending program can succeed in injecting additional money into the economy. Again, as in the case of credit contraction, we see that monetary policies alone may not be sufficient to solve the problem. Instead credit expansion may have to become a matter of fiscal policy. But even government spending can be insufficient, especially when government expenditures are overcompensated by a rapid decline in private investment.

The devaluation of the dollar did not do much to counteract the prevailing deflation, but in improving the competitive position of the dollar, it aggravated the gold inflow the greater part of which, however, must be accounted for by repatriation of United States capital, by the flight of capital to the United States because of political uncertainties abroad, by the export of gold to establish dollar credits in anticipation of war, and by rearmament and war expenditures of England and France in the United States prior to lend-lease.

Gold, instead of being equally distributed, was increasingly concentrated in the United States; and while the debtor countries suffered from deflation or tried to protect themselves through exchange control, the main creditor country was unable to follow an expansionist policy. The inflow of gold, furthermore, created excess reserves for the member banks and made them quite independent of the controlling influence of the Federal Reserve authorities.

The gold inflow was partly paid for by an export of commodities and helped, therefore, to create employment. But it is doubtful whether this export advantage for the greatest creditor country was a real economic advantage for the world as a whole or whether it too has to be classified as a *sauve-qui-peut* policy at the expense of others.

11. *The Federal Reserve System, op. cit.*, p. 57.

FREE EXCHANGES

Competitive devaluation is bad because the countries practicing it maintain artificial exchange rates which are favorable to export. If these countries instead simply go off gold and let market forces decide what the rates of exchange ought to be, we would have a system of "free" exchanges in which the domestic credit policies of the nations could be entirely independent of each other. The necessary international adjustments are left in such a system to fluctuations in the rates of exchange. These free fluctuations, however, might be violent and for this reason alone detrimental to the international movement of commodities and capital.

There is little chance that the different countries of the world would ever try to unscramble complicated international payment situations through a free pricing process on the exchange markets. A decline in the rate of exchange may be felt to be incapable of equilibrating the free market demand for and the supply of foreign exchange at a level which authorities may consider reasonable. Then, too, capital flight movements often cannot be checked by ordinary measures, and the falling exchange rate itself would become much more an incentive to further capital flight movements than one to increased exports and decreased imports.

EXCHANGE CONTROL

This latter situation is one in which debtor countries would be forced to introduce foreign exchange control. By foreign exchange control we refer to measures which replace part of the equilibrating function of the foreign exchange market by regulations alien to the pricing process.[12] The determination of the rate of exchange is not left to the free interplay of demand and supply. Rather, exchange control is a special case of price ceiling. Since demand and supply conditions would tend to increase the price of foreign currencies further than desired or considered safe, the price is officially fixed. But at the official

12. G. N. Halm, *Monetary Theory* (Philadelphia, Blakiston, 1942), pp. 153-58.

ceiling price, supply and demand are not in equilibrium. The situation necessitates, therefore, a reduction in demand by rationing (of some sort) and, possibly, an artificial increase of supply by subsidies (of some sort).

Exchange control as such is, therefore, not worse than any other form of price control, and it can be justified through the particular danger of capital flight movements which makes the exchange market more sensitive than most other markets. Situations can arise in which exchange control is the only possible solution—an excuse not equally applicable, for instance, in the case of competitive exchange depreciation.

We have to learn to distinguish between different kinds of exchange control just as we have to learn to distinguish between different kinds of inflation and deflation. If exchange control is the only possible solution in special situations, we should count exchange control among the instruments of international monetary policy and should not dismiss *a limine* a useful, though dangerous, weapon because it has been used in a malign way. Inflation and deflation can become extremely destructive and, yet, nobody would say that small doses of either medicine could not be used with advantage under given circumstances.

Foreign exchange control appeals to authorities because it promises advantages which cannot be gained on the free exchange market. It offers the possibility of exchange stability together with the independence of domestic credit policy from the limiting requirements of the gold standard mechanism; also it offers wide opportunities for its use as an instrument of commercial policy owing to the rationing of foreign exchange which it implies. Foreign exchange control, furthermore, is the indispensable link by which, alone, planned economies can be connected with the rest of the world since the planned economy has to be insulated from external disturbing influences.

The particular difficulty of exchange control is due to the fact that it requires a complicated apparatus of control to avoid circumvention. To make exchange control really effective, all receivers of foreign exchange will have to be forced to sell their foreign exchange to a central office which, then, will distribute it more or less arbitrarily in accordance with one criterion or another, since rationing will be necessary in any event, if de-

mand cannot be fully met by supply at the existing ceiling price.

Even in its mildest forms, therefore, exchange control is an unwieldy instrument which remains alien to free international exchange. For exchange economies of an unplanned character, it can only be an emergency policy which should be removed as soon as conditions permit.

That exchange control has become so utterly discredited is due to the fact that, if used exclusively for national purposes by a powerful country, it can become a weapon just about as dangerous as military conquest. And even if practiced with no malign intentions, it may easily tempt its user into foreign trade policies which would be contrary to the common interest.

A SURVEY OF THE SITUATION IN 1935

A brief summary of the monetary conditions during the inter-war period shows that it was a period of monetary chaos. A survey of the world situation around 1935 reveals the following remarkable picture.

The United States had devalued the dollar in order to increase the domestic price level but was unsuccessful in this attempt and only stimulated the flow of the world's gold to the United States.

England had depreciated the pound, gained an artificial export advantage over the gold standard countries, and enjoyed relatively prosperous conditions, but was doing so partly at the expense of other countries.

France and the other gold-bloc countries were suffering from overvaluation of their currencies (owing to the competitive devaluation of the sterling-bloc and other countries), were unable or unwilling to carry through commensurate deflationary policies, and suffered from capital flight since everybody anticipated the unavoidable depreciation of the gold-bloc currencies.

Germany, whose deflationary effort helped to bring Hitler to power, had not dared to devalue and introduced, instead, foreign exchange control which she was soon to use as an instrument of economic warfare.

The international monetary disintegration of the inter-war

period found its most striking expression in the development of bilateral agreements which tended to reduce international trade to the level where the balances of payments and even the balances of trade between any two countries are equilibrated. This means, of course, that the advantages of multilateral trade are forsaken and that international trade and international division of labor tend to shrink to the level of those exchanges which can be pressed into the form of bilateral agreements.

EXCHANGE STABILIZATION FUNDS

There were, however, a few brighter spots in this picture, the most important of which was Secretary Hull's reciprocal trade agreement program, which, while it did not produce any great changes in the height of existing tariffs, did at least stop the trend towards ever increasing tariffs.

Another constructive idea was the establishment in different countries of exchange stabilization funds which tried to counteract abnormal changes in demand on the foreign exchange markets by managing the supply, and vice versa. A typical exchange stabilization fund consists of foreign balances or gold and of domestic money, and it serves as a buffer which mitigates the impact of repercussions resulting from divergencies between the monetary and general economic policies of different countries. The connection between foreign exchange markets and domestic money markets is made subject to a controlling device which replaces, as it were, the golden brake of the credit machine by the gear shift of the stabilization fund. Whether high or low gear is used, whether the connection is entirely interrupted, or the reverse put in is a matter of conscious management.

These funds, if not used for narrow nationalist purposes (such as keeping the exchange rate from rising in order to maintain a competitive export advantage) but rather as a pool for concerted action, point to the very core of the new plans for international monetary cooperation.

The Tripartite Agreement of 1936 was a modest beginning. That it was not strong enough under the then existing conditions does not discredit its basic idea.

IV.

OBJECTIVES OF INTERNATIONAL MONETARY COOPERATION

INTERNATIONAL MONETARY COOPERATION

THE LESSONS of the inter-war period should not be forgotten. They teach, by implication, the essential objectives and requirements of a truly international monetary system; they show why the gold mechanism was inadequate to cope with the problem of post-war international finance; they prove that deliberate domestic credit and employment policies, since they are here to stay, must be integrated by international institutions; and they demonstrate that national policies which are heedless of international repercussions are doomed to eventual failure in spite of their momentary success; but they also indicate that an international monetary system cannot hope to function successfully unless the nations of the world are willing to follow accepted rules of international behavior—even if these rules are occasionally inopportune.

Any new international monetary system must, of course, be so designed as to secure a sufficient amount of freedom of action for the member countries; otherwise it will not be acceptable. We must fully grasp "the essential position which the idea of maintenance of a high level of employment has taken in current economic thought." [1] But the full employment policies must be compatible with international cooperation and with a reasonable degree of exchange stability. A compromise solution

1. See Louis Rasminsky, "International Credit and Currency Plans," *Foreign Affairs,* July 1944, p. 598.

has to be found which enables us to combine national policies which aim at full employment with an international system of multilateral clearing. This compromise is possible under the following conditions.

(1) The member countries must be given large enough reserves of international money so that they have time "to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (*Agreement* I-v). A deficit country without sufficient reserves would try to achieve balance of payments equilibrium either by increasing exports through deflation or exchange depreciation or by decreasing imports through cumulative protection and exchange control. These are the "measures destructive of national or international prosperity."

(2) The international monetary system should "not be used to prolong a basically unbalanced international position"; on the contrary, the new mechanism should "be influential in inducing countries to pursue policies making for an orderly return to equilibrium" (*White Plan,* Preamble, 3). The international institution could, indeed, not refrain from exercising pressure "on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction" (*Keynes Plan* I-1-d).

(3) This pressure should, however, not lead to increasing unemployment. Full employment is even more important than stable exchange rates. Changes in the par value of member currencies are, therefore, to be permitted if they are essential to the correction of fundamental disequilibria (*Agreement,* IV-5). But these adjustments must not be a matter of unilateral or bilateral action. An orderly and agreed collective method of exchange depreciation (or appreciation) must be provided so that competitive exchange depreciation can be avoided.

(4) Since stable exchange rates are, nevertheless, highly desirable as a sound basis of international trade and international capital movements, it is to be hoped that the full employment policies of the member countries can be integrated so that disequilibria which would require changes in the par values of the member currencies will become rare occurrences.

The International Monetary Fund of the Agreement will, therefore, be guided in all its decisions by the purpose "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems" (*Agreement* I-i). One of the greatest assets of an international monetary system would be its ability to keep the monetary authorities of the member countries in constant contact with one another and, thereby, to make, more or less automatically, all member countries conscious of their inescapable interdependence. Thinking in terms of world economy, the different national authorities could no longer ignore the effects which their policies would have on other member countries and, indirectly, upon their own economy. Thus a breach would "be made and widened in the outmoded and disastrous policy of each-country-for-itself." [2]

With the consequences of the monetary disorder of the interwar period as a warning example, it should not be too difficult to make the prospective member countries of an international monetary system realize that they are all in the same boat. It is, indeed, to be hoped that general agreement already exists concerning a wide range of important problems.

REQUIREMENTS AND OBJECTIVES OF AN INTERNATIONAL MONETARY SYSTEM

The following pages contain an enumeration of the requirements and objectives of an international monetary system as they are either expressly stated or implied in the new proposals. Some of these objectives transcend the field of action of an International Monetary Fund, but they are mentioned as preconditions of successful international monetary cooperation.

(1) *Commodity movements.* Basically, and in the long run, exports pay for imports. The smooth functioning of international payments requires, therefore, that movements of commodities and services between countries should not be seriously obstructed.

2. Harry D. White, "Postwar Currency Stabilization," *American Economic Review,* March, 1943, Supplement, p. 386.

(2) *Capital movements.* International movements of capital in the direction of highest marginal efficiency are desirable from the standpoint of both the debtor and the creditor country, provided that the increased efficiency raises the export possibilities of the debtor country and provided that the creditor country is later on willing to accept interest and amortization in the form of increased imports.

(3) *Fair competition.* International trade should take place under the general maxim of the most-favored-nation principle in its unconditional form [3] and under strictest elimination of competitive exchange depreciation and other unilateral actions designed to secure unfair competitive advantages.

(4) *Multilateral clearing.* International trade should be multilateral and not bilateral since bilateral agreements tend to reduce international trade to the transactions which can be cleared between any two countries. International trade is multilateral when "each nation can be assured of facilities for spending in one part of the world what it is earning in some other part of the world." [4]

(5) *Reasonably stable rates of exchange.* International trade and international capital movements require reasonably stable exchange rates. Exchange fluctuations should not seriously interfere with legitimate trade and investment profits. Changes in the par values of the member currencies of an international monetary system should, therefore, be rare events and exchange rates should remain fixed within narrow limits until the par values of the member currencies are changed by mutual consent.

(6) *Orderly pattern of exchange rates.* The exchange rates must be initially so determined that no member country enjoys either an export advantage through undervaluation of its currency or suffers from an export disadvantage through overvaluation of its currency. Since only experience can show

3. The principle of unconditional most-favored-nation treatment gives the foreign trader of every country the right not to be treated worse than the trader of any other country.

4. See D. H. Robertson, "Post-War Monetary Plans," *Economic Journal,* December 1943, p. 353.

whether the rates have been chosen correctly, methods of revaluation internationally agreed upon must be available to prevent competitive depreciation by unilateral action.

(7) *Domestic policies.* Domestic policies for economic stabilization and full employment should be compatible with a reasonable amount of exchange stability. But price and exchange stability should not necessarily be considered as more important than a high level of employment and real income. Increasing protection, competitive exchange depreciation, and abnormal credit expansion should not be used to create full employment because they could not be successful in the long run. "Most nations cannot achieve satisfactorily full employment without more international trade, unless they gravely reorient their economic life. They cannot proceed intelligently to solve the problem of unemployment and underemployment unless they can forecast to some degree what their export markets will be and on what terms imports will be available." [5]

(8) *Full employment.* "It is equally important to realize, on the other hand, that a satisfactory volume of international exchange, and satisfactory solutions to many of the most persistent international economic issues cannot be achieved unless reasonably full employment can be reached, in the major countries at least." [6] Unemployment leads invariably to each-country-for-itself policies which, while they do not improve the employment situation in the long run and for the world as a whole, tend to destroy international trade and lower the standard of living throughout the world.

(9) *Integration of national policies.* Since national credit policies are not to deviate too far from the international equilibrium (so that reasonably stable exchanges can be maintained), the credit policies of the member countries must be sufficiently integrated to guarantee to each country a supply of money and credit, national as well as international, commensurate with reasonably full employment. But it is to be

5. See Robert Bryce, "Basic Issues in Postwar International Economic Relations," *American Economic Review,* March, 1942, Supplement, p. 166.

6. *Ibid.,* pp. 166-67.

expected that individual member countries will, nevertheless, tend to depart from the equilibrium owing either to local conditions or to different interpretations of the situation. This disequilibrium will express itself in the balance of payments of the country with the rest of the world and in a maldistribution of the reserves of international money.

(10) *Stabilizing mechanism.* An international monetary system requires, therefore, a stabilizing mechanism "by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction, so as to prevent movements which must create for its neighbors an equal but opposite want of balance" (*Keynes Plan* I-1-d). This pressure must affect domestic policies of the deviating countries and to that extent the mechanism cannot remain exclusively in the international *terrain*.

(11) *Creditor countries.* Deviating countries can be creditor countries as well as debtor countries. "The creditor should not be allowed to remain entirely passive. For if he is, an intolerably heavy task may be laid on the debtor country, which is already for that very reason in the weaker position" (*Keynes Plan* IV-17). In the light of inter-war experiences it is important that the reciprocal character of the monetary mechanism should be emphasized. Care has to be taken, however, that the deflationary emphasis on the responsibilities of the debtor countries is not simply exchanged for an inflationary overemphasis on the responsibilities of the creditor countries.

(12) *Reserves of international money.* The pressure to be exerted on the deviating countries is not a disciplinary measure, but, rather, the application of a sort of "synthetic index" which helps to detect conditions of disequilibrium. The mechanism may require action in the domestic sphere when disequilibria of a more than temporary character have been found to exist. Purely temporary disequilibria in the balance of payments, which are bound to arise frequently, are overcome by drawing against the reserve of international money which will be put at the disposal of each member country. Only if a country has to draw permanently on its reserve, will there be reason to suspect that a more fundamental dislocation has occurred. Even in this

case, however, the existence of an adequate reserve of international money will function as a shock absorber against the impact of corrective measures upon the domestic economy. Of course, the adjustment may have to take place in form of a change in the par value of the member's currency.

(13) *Character of these reserves.* While it is of the utmost importance that sufficient reserves of international money should be put at the disposal of member countries, it is essential to understand clearly that these reserves are an operational fund which should not be squandered on payments which are not likely to return in due course[7] and that it is not their function to take the place of long-term or even medium-term credits but to give member countries time to correct maladjustments in their balances of payments.

(14) *An International Monetary Fund.* It is only a technical question, though a question of great importance, whether an international institution of the character of an International Monetary Fund is to be created. It would be possible to handle the major problems by agreements. The national monetary authorities could, for instance, assure the stability of exchange rates by undertaking to acquire, at specified rates, the currencies of other participating countries.[8] Questions of world credit policy could be decided upon by conferences at frequent intervals.[9] But it would be an obvious step towards simplification to concentrate international monetary functions in one central institution.

(15) *International money.* International money—money which could buy everywhere—cannot be created. But we can pool national currencies and gold and give to the member countries the right to buy any currency they desire from the common Fund. (Similarly we could arrange for overdraft facilities in an international credit pool.) Gold can still perform the important function of a "transformer" of national currencies. The use of an international unit of account (Gold-dollar, Unitas,

7. *The Times,* London, July 31, 1943.

8. See "French Plan for an International Monetary Agreement," *New York Times,* May 9, 1943.

9. See above, Chapter III, p. 30.

Bancor) could possibly facilitate the transactions of an International Monetary Fund.

THE TRANSITION PERIOD

Concerning most of these points a good deal of agreement exists among monetary experts. Differences of opinion arise, however, as soon as these general ideas are to be implemented by concrete proposals. Before we turn to a discussion of the provisions of the new monetary plans, we have first to consider the special problem posed by the period of transition from war to peace.

Until now we have concentrated our attention mainly on the objectives and requirements of an international monetary system of a normal and permanent character. Experiences of inter-war years served, by contrast, to underline those conditions which are to be considered as a normal and reliable basis for monetary equilibrium in international economic relations. Once these conditions are fulfilled, we hope to be able to maintain international economic stability to a reasonable degree.

Unfortunately we are as yet very far from this ideal state of things. The results of the disorder of the inter-war period were frozen at the outbreak of World War II, and the new war has added new and grave problems to an already very complicated situation.

When the war ends, all the countries of the world will find themselves in a state of economic disequilibrium. They will have to shift from wartime production to the production of civilian consumers' goods. In this period of transition, conversion unemployment will tend to decrease demand, but dissaving and the shortage of consumers' goods will, nevertheless, lead to inflationary trends. Under these conditions it will hardly be feasible to relax, immediately after the war, those domestic controls which have kept the inflationary tendencies of the war economy in check. But as long as the domestic economies are subject to price ceiling, rationing, priorities, and other devices, we shall not be able to determine the actual domestic purchasing power of the different currencies; and this makes it, in turn, exceedingly difficult, if not impossible, to determine the foreign

exchange rates which correspond roughly to the relative purchasing powers of the different national currencies. Thus exchange control will have to be retained for some time after the war and should only be relaxed gradually. While most exchange control measures should be abolished as soon as international monetary equilibrium has been reached, it would be unwise to expose the external value of the currencies of the deficit countries to the forces of demand and supply before these countries have been able, with foreign help, to stabilize their national economies.

RELIEF AND RECONSTRUCTION

Many nations will face problems far more formidable than the mere transition from war production to a peace time economy, and most of these problems will relate to their balances of payments. "The distress will arise from the fact that the countries in question will have neither gold nor other internationally marketable reserves to take care of a deficit in the respective balances of payments. These balances will be in disequilibrium due to the depletion of inventories, the accumulation of short-term debts, the destruction of productive facilities, the loss of external sources of revenue and difficulties in adapting their exports to new competitive situations." [10]

If no concerted effort is made, if no help for the deficit countries is forthcoming after the war, we shall continue with the hapless practices of the inter-war period. The debtor countries would most certainly refuse to pay the deflation price of unemployment for international payment equilibrium, and would again embark on competitive exchange depreciation, exchange control, and bilateralism.

To avoid the continuation of these practices is to the vital interest of all nations, including the creditor nations. If the creditor countries help the debtor countries to solve their problems, the creditor countries will act in their own long-run interest. This point is almost generally understood. But the practical problem is again to find adequate means to accom-

10. See M. Palyi, "A Tentative International Monetary Stabilization Plan," *The Commercial and Financial Chronicle*, August 12, 1943.

plish this task, which is much larger than the problem of international monetary cooperation.

The first and most urgent problem is one of relief. To cope with it a *United Nations Relief and Rehabilitation Administration* (UNRRA) has already been created to which uninvaded countries will make a contribution (if possible in part in foreign exchange) of one per cent of their national income.[11]

Another important post-war problem will be the "unprecedented need for foreign capital."[12] Private capital will not be sufficient to provide the necessary funds for reconstruction, conversion, and development. "Private capital will understandingly hesitate to venture abroad in anything like the required volume. It has suffered too many losses from war, from depreciating currencies, from exchange restrictions, and from failures and defaults. There is little evidence to justify the hope that in the years immediately after the war investors will lend large sums that can be economically used in foreign countries unless steps are taken to restore confidence in foreign investment."[13]

The U.S. Treasury prepared, for this reason, a *Preliminary Draft Outline of a Proposal for a Bank for Reconstruction and Development of the United and Associated Nations.* This Draft Outline was discussed, together with the Joint Statement, at the International Monetary and Financial Conference at Bretton Woods where the delegates of forty-four nations finally signed *Articles of Agreement for the Establishment of an International Bank for Reconstruction and Development.*[14]

Since the International Bank is designed as a companion agency to the International Monetary Fund, and because of its very great importance, we shall devote Chapter XIII to a brief discussion of its purposes and operations though we violate, in

11. Cf. Philip C. Jessup, "UNRRA, Sample of World Organization," *Foreign Affairs,* April 1944, pp. 362-73; Vera Micheles Dean, "UNRRA—A Step towards Reconstruction," *Foreign Policy Reports,* Vol. XIX, No. 20, January 1, 1944, New York.

12. See Secretary Morgenthau's Foreword to the *Preliminary Draft Outline of a Proposal for a Bank for Reconstruction and Development of the United and Associated Nations,* November 24, 1943, U.S. Treasury, Washington, D.C.

13. *Ibid.,* p. ii.

14. See Appendix V.

doing so, the otherwise exclusively monetary character of the present study.

THE PROBLEM OF TIMING

If seen as part of a more comprehensive effort, the new monetary plan could perhaps be considered as less urgent since other agencies seem to take care of the more immediate post-war needs. It can even be argued that, until the emergency problems of the transition period are solved, no arrangement for stability of international exchanges can be expected to operate successfully and that the plans are therefore putting the cart before the horse.[15]

Especially Professor Williams has "expressed doubts about the wisdom of adopting at once a formalized plan, with rules and procedures, votes and quotas, and an international governing body."[16] Against this cautious and hesitating attitude can be held the convincing argument that "major plans will be more easily brought to birth in the first energy of victory and whilst the active spirit of united action still persists" (*Keynes Plan* X-41).

We shall have to discuss the problem of timing more thoroughly in Chapter XII. May it suffice in the meantime to use Professor Robertson's convincing statement that the very fact that many countries "will be in a sorry condition after the war, not capable of playing their full part at once in an international system, is surely an argument for *organising* their return to such a system rather than leaving them to scramble back as best they may."[17]

The problem of transition cannot be separated entirely from the more permanent set-up since the transition problem will reach far into the future. As we speak of a "normal" and of a transition period we should never forget that "normal" times actually never come. If we can judge from the aftermath of World War I, we may have to distinguish with Professor

15. See "The World Bank Proposals," *Fortune,* August 1943, pp. 179, 139.

16. Williams, "The Postwar Monetary Plans," *loc. cit.,* p. 383.

17. Robertson, "The Post-War Monetary Plans," *loc. cit.,* p. 355.

Slichter [18] not only one but three periods before we shall have reached anything like normal times, namely (1) a transition period from war to peace; (2) a catching-up period of high employment, lasting perhaps five to ten years, based upon deferred purchases, liquidation of surplus saving, and the adjustment of stocks of goods to new high levels of income; and (3) a difficult transition from this catching-up period to a self-sustaining economy. For the creditor countries this second transition period would have to include the development of an import surplus.

That we shall not reach really normal times within the next ten or fifteen years shows clearly that the establishment of an International Monetary Fund cannot be postponed until all the conditions for permanent equilibrium are fulfilled. The Fund should be ready by the end of the war [19] and should be put into operation as soon as possible just because the more endangered currencies of smaller deficit countries will need special help and protection. Such measures as relief and reconstruction will, of course, best be handled outside the monetary stabilization plans.[20] But functions like the gradual relaxation of exchange control measures or the finding of correct exchange rates should be the domain of the new international monetary system.

18. Sumner H. Slichter, "Foreign Trade and Post War Stabilization," *Foreign Affairs*, July 1943.

19. Article XX-4-h of the Agreement provides that the Fund shall begin exchange transactions "in no event until after major hostilities in Europe have ceased."

20. See Agreement XIV-1: "The Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of the war."

V.

AN INTERNATIONAL RESERVE BANK

A BANK OF CENTRAL BANKS

THE NEW PLANS for international monetary stabilization, with the exception of the French Plan, propose the creation of an international banking institution. Whether this institution is called an "International Clearing Union," a "United and Associated Nations Stabilization Fund," or an "International Monetary Fund" makes little difference. All the proposed institutions can be considered as different blue prints of an International Reserve Bank,[1] in analogy to the Central Reserve Banks of the different national credit systems. For the sake of clarity, therefore, we shall call the international institution an International Reserve Bank when we do not refer to a particular plan.

That the new plans try to solve the problem of international monetary stabilization by setting up an International Reserve Bank is the consistent conclusion of the development which led to the creation of Central Banks within the national credit systems.

After the establishment of an International Reserve Bank, we would have the following set-up: as before, the individuals and business firms in the different countries of the world hold their cash balances with their local commercial banks and the commercial banks in turn have their reserve balances in the Central Banks. But now the Central Banks, unlike before, would hold their balances of foreign money, at least partly, in the Interna-

1. See Hans P. Neisser, "An International Reserve Bank," *Social Research*, September, 1943, pp. 265-79; also Palyi, "A Tentative International Stabilization Plan," *loc. cit.*

tional Reserve Bank as the crowning organization of the world's monetary system.

WHY CENTRAL RESERVE BANKS CAME INTO BEING

The basic functions of an International Reserve Bank can better be understood if we first recall why Central Reserve Banks came into being. The Federal Reserve Banks of the United States, for instance, hold the reserve accounts of their member banks just as the member banks hold the check accounts of their customers. The check accounts of the member banks' customers are derived mainly from loans given to borrowing customers or from investments bought. The commercial banks, therefore, create most of the demand deposits of our economy. But in creating demand deposits the commercial banks create claims against themselves. Either they must stand ready to pay out currency, if so required, or to have the amount which the customers check out charged to their reserve accounts with the Federal Reserve Banks. Thus a commercial bank is liquid only if it is, at any time, able to meet demand for cash as well as passive clearing balances. In other words, a commercial bank needs reserves. These reserves of the commercial banks consist today, almost exclusively, in reserve deposits in Central Banks.

This seems so obvious that it needs some mental effort to visualize the position of a commercial bank in a system without a Central Bank. If, in case of emergency, the commercial bank would have to rely exclusively on its own liquid funds (that is the currency and gold in its vaults), the reserves would have to be excessively large. But by pooling their scattered reserves, the commercial banks can apply the law of large numbers (or the "insurance principle") in a way which reduces substantially the total amount of reserves needed. One bank or even a group of banks can now, in case of emergency, be supplied with the necessary reserve funds from a common reservoir. As long, however, as the pooling of reserve funds is done not in a Central Bank but only in the commercial banks of the financial centers of the country, a nation-wide emergency situation cannot be overcome because, in this case, the reserve funds are needed

everywhere at the same time. The situation can only be met by a Central Bank which can create more currency when more currency is needed. It was, therefore, only logical that Bankers' Banks should be established; that is, Central Reserve Banks in which the commercial banks concentrate their reserve funds not only to make use of the pooling principle, but also in order to obtain an increased total supply of reserve funds to meet a nation-wide demand for currency.

To sum up the advantages of a Central Reserve Bank we may say:

(1) that better use is made of the loanable funds of the economy by cutting down the amount of idle reserves for the system as a whole;

(2) that in times of crisis a deflationary liquidation process may at least be ameliorated by a Central Bank which has the power to create additional reserve funds;

(3) that, on the other hand, overexpansion of credit, through parallel action of the commercial banks, can be prevented either by lowering the reserve funds or by raising the reserve requirements;

(4) that an institution is created which can easily and economically fulfill service functions for the commercial banks, especially the function of clearing checks; and

(5) that an authority is established for "the maintenance of monetary and credit conditions favorable to sound business activity." [2]

We should not enumerate these advantages, however, without recalling that the powers of the Central Bank are limited. In particular the Central Bank can make more money available, but it cannot, naturally, force business to borrow; and it can enforce credit contraction, but it is not always able to decrease prices and costs simultaneously (as when, for instance, industrial monopolies and labor unions refuse to reduce prices and wages).

2. *The Federal Reserve System*, Washington, 1939, p. 23.

INTERRELATIONSHIPS OF CENTRAL BANKS

As long as the policies of the different Central Banks are not coordinated by an International Reserve Bank, their interrelationships may be of three different kinds.

(1) In the case of the *gold standard mechanism* the Central Banks use their powers for the single purpose of maintaining a stable rate of exchange in relation to other currencies through the closest possible adjustment of the price level of the country to the average world price level. But they must subordinate all other possible objectives to this single purpose.

(2) In the case of *free exchanges* the Central Banks can pursue whatever credit policies they choose, heedless of the policies of other countries. But such action is incompatible with the maintenance of stable foreign exchange rates since exchange rates must fluctuate roughly in proportion to the changes in the domestic price levels which the independent national credit policies of the Central Banks call forth.

(3) In the case of *foreign exchange control* the Central Banks of any two countries may easily be tempted to conclude bilateral clearing agreements which replace the multilateral clearing of the gold standard mechanism or of the system of free exchanges. In a bilateral clearing agreement importers pay domestic money into a fund with the Central Bank out of which exporters will be paid, thus establishing a self-contained payment mechanism in each country.[3] This system tends to equalize the balances of payments, if not the balances of trade, between any two countries but, in doing so, destroys the tremendous advantage of multilateral trade.

All three types of interrelationships between Central Banks are unsatisfactory as Chapters II and III tried to show. The gold standard mechanism stabilizes foreign exchange rates, but is incompatible with deliberate domestic credit policies other than those which strictly conform to the rules of the gold standard game. The system of free exchanges is either heedless of credit policies of other nations and thus does not provide for

3. See P. T. Ellsworth, *International Economics* (New York, Macmillan, 1938), pp. 408-9.

international trade and international capital lending the solid foundation of stable exchanges, or, even worse, might well induce competitive exchange depreciation. And the bilateral system is essentially a totalitarian system particularly fitted for the exploitation of weaker nations by the "master" country from whose Central Bank, as the center of the spider web, radiate the bilateral agreements.

ADVANTAGES OF AN INTERNATIONAL RESERVE BANK

The establishment of an International Reserve Bank would create an entirely different situation. Concluding the development which led to the creation of Central Banks, it would put the capstone into the structure of the monetary system of the world. It would perform functions for the Central Banks similar to those which the Central Banks now perform for their commercial banks.

The advantages of the establishment of an International Reserve Bank would be the following:

(1) An International Reserve Bank would create a mutual exchange pool of international money, available to all member countries, which would give members "time to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity" (*Joint Statement* I-3).

(2) The International Reserve Bank would not only pool, but actually create funds [4] of international money, just as it would have the power to contract the quantity of international currency. With this provision, the International Reserve Bank would overcome for example the basic defect of the old gold standard mechanism in which the quantity of the international currency, gold, was dependent on such "chancy" factors as the technique of gold production. World-wide inflationary and deflationary tendencies could, for the first time, possibly be brought under control, just as the Central Banks can, within

4. Strictly speaking this is only true for the Keynesian Clearing Union. Dr. White's Stabilization Fund as well as the International Monetary Fund would not create international money. But we shall see that these Funds could, nevertheless, make more "international currency" available.

limits, control credit expansion and credit contraction within the national economies.

(3) Through the deliberate adjustment of the quantity of international currency to the "actual current requirements of world commerce" (*Keynes Plan* I-1-c) and through exertion of pressure on the member countries to conform to credit policies commensurate with this quantity, exchange rates could be stabilized without forcing the member countries into policies which are too inconsistent with domestic stabilization.

(4) If deliberate control of the quantity of international currency should not succeed in simultaneously securing exchange stability and domestic economic stability in the different countries, the necessary adjustments of exchange rates to national price levels could be achieved in such an orderly manner that competitive exchange depreciation would be prevented.

(5) Lord Keynes calls his Clearing Union a *generalized* payments agreement to show that it would restore "unfettered multilateral clearing between its members" (*Keynes Plan* V-19). It would, undoubtedly, be one of the main functions of an International Reserve Bank "to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade" (*Agreement* I-iv).

(6) An International Reserve Bank would "have at its disposal more information regarding the currents of international financial transactions and the causes of disequilibrium than has ever been available before" (*Canadian Plan,* General Observations, 12); it would act "as a centre for the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies designed to assist members in developing policies which further" its purposes (*Agreement* VIII-5-c).

PURPOSES OF AN INTERNATIONAL RESERVE BANK

If we exclude the problems of the transition period which an international monetary institution might help to solve, we can, therefore, enumerate the following purposes of an International Reserve Bank:

(1) "To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems" (*Agreement* I-i; *Joint Statement* I-1).

(2) To pool or to create reserves of international currency in order to give confidence to members by making foreign exchange available to them thus allowing "time and method for necessary adjustments and comfortable safeguard behind which the unforeseen and the unexpected can be faced with equanimity" (*Keynes Plan* IV-16 and I-1-e; *Agreement* 1-v; *Joint Statement* I-3; *White Plan*, Preamble 3; *Canadian Plan*, General Observations, 10).

(3) "To reduce the use of such foreign exchange restrictions, bilateral clearing arrangements, multiple currency devices, and discriminatory foreign exchange practices as hamper world trade and the international flow of productive capital" (*White Plan* I-5; *Agreement* I-iv; *Joint Statement* I-3,4,5; *Canadian Plan* I-5; *Keynes Plan* I-1-a).

(4) "To shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members" (*Agreement* I-vi; *Joint Statement* I-6; *White Plan* I-2) through the establishment of "an international stabilising mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium" (*Keynes Plan* I-1-d; *Canadian Plan* I-4).

(5) "To promote exchange stability" (*Agreement* I-iii; *Joint Statement* I-4; *White Plan* I-1; *Canadian Plan* I-1).

(6) To provide "an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations

are prevented" (*Keynes Plan* I-1-b; *Canadian Plan* I-1; *Joint Statement* I-4; *Agreement* I-iii).

(7) "To assist in the establishment of a multilateral system of payments in respect of current transactions between members" (*Agreement* I-iv; *Joint Statement* I-5; *Canadian Plan* I-2).

(8) "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy" (*Agreement* I-ii; *Joint Statement* I-2; *White Plan,* Preamble 2; *Keynes Plan* IX-39-5).

(9) "To aid and to support other international institutions concerned with the planning and regulation of the world's economic life" (*Keynes Plan* I-1-f, *Agreement* X).

(10) Generally "to help create conditions under which the smooth flow of foreign trade and productive capital among the member countries will be fostered" (*White Plan* I-3).

INTERNATIONAL MONEY

To understand the working of the prospective International Reserve Bank it is imperative that we become familiar with the special kind of funds which it pools, borrows, and, perhaps, creates. To say that these funds consist of "international money" is probably correct but requires further explanation.

The funds of the new International Reserve Bank would be different from the funds handled by national Central Banks. A Central Bank controls a national banking system and its operations are based on a national monetary unit; but the International Reserve Bank will be located, as it were, between the national credit systems in monetary no-man's-land.

All money, national as well as international, is only a means of exchange and a unit of account. As a means of exchange it has value for us because it can buy commodities, services, and securities. But all these purchases are made within national boundaries, and within national boundaries only domestic money can buy. Thus we seem to be forced to the conclusion that international money does either not exist or is a kind of

money which can buy everywhere. This latter statement, however, contradicts the fact that no means of payment is acceptable as legal tender beyond the border of the issuing country. What, then, is international currency?

A possible answer seems to be: gold. Gold is, indeed, the only article which, in modern times, has at least approached the quality of an international currency. It has the not entirely negligible quality of "intrinsic value" and it performs, as long as the different countries are on the gold standard or as long as the par values of their currency units are expressed in terms of gold, the function of an international unit of account by establishing exchange rates between the national currencies.

A second answer to the question concerning the nature of international currency would be that it is simply "foreign balances." Foreign balances are balances in the banks of other nations, acquired through the export of commodities, services, or securities, and are, therefore, "foreign currency" from the domestic standpoint. In reality, however, they are only claims on domestic currencies of other countries.

But, as soon as we step into the monetary no-man's-land where the International Reserve Bank is located, our outlook changes. Our very position makes *all* national currencies at the disposal of this International Reserve Bank appear as "foreign currency." Credit created in the books of the International Reserve Bank, too, would be "foreign exchange" since it would only be used to buy in "other" countries. In its capacity as the holder of the international exchange pool, the International Reserve Bank would be able to supply its customers—the Central Banks—with the currencies of all the member countries.

An assortment of national currencies in an International Monetary Fund, or even better, the purchase rights to such an assortment, can perhaps be considered as "international currency," just as the overdraft privileges of the members of the Keynesian Clearing Union would amount, when used, to the creation of "international bank money"—if we care to stretch our monetary vocabulary that far. Through the invention of a name for the unit of "international money" (Unitas, Bancor, Gold-dollar) we could add the function of an international unit

of account to the function of an international means of exchange. It would undoubtedly be a convenience to have a unit of account for the transactions of an International Reserve Bank. This convenience would grow into a practical necessity if the member currencies were not linked to gold, since a common denominator must be given to express the par value of the member currencies.

Since all plans propose to use gold as common anchorage for the local currencies, newly invented names are of secondary importance. The esperanto quality of these names tended to give to the White and Keynes plans a somewhat artificial flavor.

If it were politically feasible, the gold dollar could be used in a way similar to the adoption of the gold franc by the Bank for International Settlements (B.I.S.).[5] Since the monetary use of gold is largely due to psychological reasons it would be unwise to forego the prestige and lustre which an international organization would gain in the eyes of naïve spectators by the stressing of the fact that the whole system is based on, not to say "backed by," gold. But, of course, this stratagem is lost on those whom the very idea of being tied to gold seems to give an attack of asthma.

The Articles of Agreement of the International Monetary Fund do not contain a newly invented name for the international monetary unit but provide that "the par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944" (IV-1-a). It is not impossible that the convenience of having a unit in which to calculate international values will gradually push the gold dollar into the position of an international unit of account.

But where does international money come from? In the Keynesian scheme it is created *ad hoc,* as we shall see, when the member countries make use of their overdraft privileges.

The international institutions proposed by Dr. White and the Canadian experts do not have the power of money creation.

5. See Arthur Nussbaum, "International Monetary Agreements," *American Journal of International Law,* April 1944, pp. 254-55.

Their resources depend on contributions and on their right to borrow additional funds from the member countries. The same approach has been chosen in the Joint Statement as "the most practical method of assuring international monetary cooperation (*Joint Statement,* Introductory Remarks). The International Monetary Fund proposed by the Joint Statement and elaborated in the Agreement receives its resources of international money through capital subscriptions and through borrowing. But by stretching our terminology somewhat, we can argue that the International Monetary Fund "creates" international currency in the sense that it gives to the resources of national currencies, which are paid into the international exchange pool, the character of "foreign currency." In addition we have to consider that the "local funds" which the member countries are asked to contribute, are, if they are not gold, probably created for this very purpose by the national monetary authorities. Nobody would suggest that the member countries should withdraw from domestic circulation an amount of currency equal to their contribution (minus the gold contribution) to the international exchange pool—a policy which would cause a most unnecessary deflationary tendency.

Thus we see that the resources of the International Monetary Fund would, at least partly, be created by the monetary authorities of the member countries while the International Monetary Fund would bestow upon these resources the new and distinct quality of "International currency." This point is of more than just terminological importance. We saw that it is essential that a Central Bank should have the power to create reserve funds. If an International Monetary Fund can (through borrowing) make a greater assortment of local currency available it can improve the reserve position of the member countries. By analogy it is, therefore, permissable to say that the International Monetary Fund has, in a broader sense, the power to "create" reserves of international money.

VI.

THE INTERNATIONAL MONETARY FUND

BASIC WORKING PRINCIPLES OF THE INTERNATIONAL MONETARY FUND

THE ARTICLES OF AGREEMENT for the establishment of an International Monetary Fund are an elaboration of the Joint Statement which, in turn, followed, in its general approach, the proposals of Dr. White and the Canadian experts.

The Agreement is a rather difficult document whose implications are not always easy to grasp. What Mrs. Robinson said about the first draft of the White Plan remains true for the Agreement: it contains a set of rules without explanations and "has to be read in the spirit of a detective story."[1]

In the present chapter we shall try to keep the broad outlines of the International Monetary Fund as free as possible from details of lesser importance; and to make the general working principles of the Fund stand out more clearly, we shall postpone the main discussion of such very important items as exchange rates, changes in par values of member currencies, quotas, etc.

The Agreement proposes the creation of an International Monetary Fund as the most practical method of assuring international monetary cooperation (*Joint Statement*, Introductory Remarks). The Fund is a mutual exchange or credit pool to which the member countries contribute their own currencies and gold, and from which they can buy other members' currencies. The basic idea is, therefore, of convincing simplicity: accepted and tested principles of Central Banking, particularly

1. See Robinson, *op. cit.*, p. 167.

the pooling of reserves, are applied and adjusted to the international monetary field.

Each member country subscribes in gold and in its own currency a carefully determined amount assigned to it which is called its *quota* (III-1). The obligatory minimum gold contribution is "the smaller of (i) twenty-five per cent of its quota; or (ii) ten per cent of its net official holdings of gold and United States dollars" at the time when the Fund's operations begin (III-3).

When a country is admitted to membership, the par value of its currency will be agreed with the Fund and will be expressed in terms of gold or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944 (IV-1). "The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin" (IV-2).

A change in the par value of a member's currency can only be approved of by the Fund "if the change is necessary to correct a fundamental disequilibrium" (IV-5-f). In this first outline of the working principles of the Fund, we shall assume, unless otherwise stated, that no changes in exchange rates will take place.

A member country deals with the Fund "only through its Treasury, central bank, stabilization fund or other similar fiscal agencies" (V-1). The Fund is a Banker for Central Banks as shown in Chapter V. The student of the new international monetary scheme must rid himself entirely of the idea that the Fund "would be an enormous organization and that every transaction throughout the world would have to be cleared through its offices. As we envisage the . . . Fund it would have in effect very little to do with every-day business." [2]

As the Fund begins to operate members will buy from the

2. Edward M. Bernstein in *Banking Sessions*, Report of Proceedings at the Thirtieth National Foreign Trade Convention, New York, October 25, 1943, p. 40. Dr. Bernstein refers to the Stabilization Fund of the White Plan.

Fund other members' currencies and pay for them in their own national currencies. Thus, if the Banque de France needs dollars it will be permitted to draw against the Fund's account with the Federal Reserve Bank of New York. The Fund's dollar account will go down and its franc account with the Banque de France will go up.[3]

That France should want to buy dollars could result from any of the many causes which may render the supply of another country's currency temporarily inadequate on her foreign exchange market. We note that the case is essentially the same which, in the times of the old gold standard mechanism, would have led to a flow of gold from France to the United States. And just as the actual flow of gold was not a frequent and regular feature of the gold mechanism, so will heavy and prolonged purchases from the Fund be considered abnormal, though we do not care to drive the analogy too far. It should, therefore, be kept in mind that the Fund will only be used to balance temporarily unbalanced situations *while the overwhelming amount of international payments is cleared without the help of the Fund.*

The disequilibria which the Fund helps to bridge are supposed to be temporary so that, when we average one period with another, and give time to correct maladjustments, equilibrium will again be restored. It is, as we have already seen, the expressed purpose of the proposed International Monetary Fund "to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members" (I-vi) and to help the members to correct maladjustments "without resorting to measures destructive of national or international prosperity" (I-v).

This also proves that, if the members avoid persistent deviations from equilibrium, the Fund will always be able to fulfill its function of providing the members with the currencies of other members. As the Fund's resources of some member currencies decrease its holdings of other member currencies

3. The changes are the same in terms of par values, not considering a service charge which in our case France, the country which made the application to draw on the Fund's resources, would have to pay.

increase. Assuming that the temporary disequilibria occur in different countries at different times, the pooling principle should work to perfection: the resources of the Fund would be constantly reshuffled and their liquidity maintained.

But, of course, persistent deviations from international payment equilibrium must be avoided. This can only be accomplished if the new international monetary system contains equilibrating devices, devices which concern both the deficit countries and the surplus countries. A deficit in one country is a surplus in another and the corrections of maladjustments must, therefore, be approached from both ends.

PROVISIONS FOR DEFICIT COUNTRIES

The International Monetary Fund, amounting altogether to 8.8 billion dollars, if all the United and Associated Nations subscribe, is not inexhaustible. While all the member currencies paid into the Fund are potentially offered for sale, the Fund may exhaust, say, its dollar resources.

The purchasing rights of *many* members, if directed predominantly against the currencies of a *few*, may lead to a situation in which, since the transactions take place at fixed prices (par values of the respective currencies), finally only rationing of the scarce currencies may be able to maintain an artificial equilibrium between demand and supply. How can this situation best be avoided?

First of all, the purchasing rights of the members must be limited. The Agreement allows a member "to buy the currency of another member from the Fund in exchange for its own currency subject to the following conditions" (V-3):

1. The payments for which the member needs the currency must be consistent with the provisions of the Agreement;

2. The Fund must not have given notice "that its holdings of the currency desired have become scarce," in other words, the currency demanded is not rationed;

3. "The proposed purchase would not cause the Fund's holdings of the purchasing member's currency to increase by more than twenty-five per cent of its quota during the period of twelve months ending on the date of the purchase nor to exceed

two hundred per cent of its quota, but the twenty-five per cent limitation shall apply only to the extent that the Fund's holdings of the member's currency have been brought above seventy-five per cent of its quota if they had been below that amount;"

4. The Fund must not have previously declared that the member "desiring to purchase is ineligible to use the resources of the Fund." This declaration could be due to violation, on the member's part, of provisions of the Agreement (e.g., an unauthorized change in the par value of its currency) or to the fact that the member is using the Fund's resources "in a manner contrary to the purposes of the Fund" (V-5).

Now it is not always easy to prove that a member is using the resources of the Fund contrary to the Fund's purposes. Exchange stability, e.g., is one of the purposes of the Fund. An inflationary policy which would lead to international payment disequilibrium and to continued purchases from the Fund could, therefore, be considered at variance with the purposes of the Fund were it not for the provisions of Article IV-5 according to which a requested change in the par value of a member's currency would have to be granted when "necessary to correct a fundamental disequilibrium." Assuming that such a disequilibrium was due to price inflation could, then, the Fund insist that the inflationary policy be discontinued as contrary to exchange stability and could the member be declared ineligible if it refused to comply? Hardly, since Article IV-5-f states that the Fund shall not object to a proposed change in the par value of a member's currency "because of the domestic social or political policies of the member proposing the change." This point needs clarification.

The most important of the above mentioned conditions is, of course, condition three, which limits the total purchases of a member and also the amount that can be bought within any one year.

Let us assume that a country's quota is the equivalent of 100 million dollars. The country contributes 75 million dollars in its local currency and 25 million dollars in gold. As the Fund begins its operations it may sell to the country a maximum of 125 million dollars' worth of foreign exchange (within a mini-

mum period of five years) and, thus, increase its holdings of the currency of the member to the equivalent of 200 million dollars. The Fund can, if there is demand for it, sell the member's currency to other member countries. The Fund's resources of the member's currency may, therefore, increase or decrease. The better the member balances imports and exports of commodities, services and securities, the smaller will be the fluctuations of the Fund's holdings of the member's currency around the original amount equivalent to 75 million dollars. Assuming that the Fund's holdings of the currency had gone down to, say, 20 million dollars, the member would be permitted to buy 55 million dollars' worth of foreign exchange from the Fund without any limitation whatsoever. Assuming, however, that the Fund's holdings of the currency are restored to the original amount of 75 million dollars, the member could only acquire 25 million dollars' worth of foreign exchange from the Fund in any twelve-months period. Altogether it could buy 125 million dollars' worth of foreign exchange since this would bring the Fund's holdings of the member's currency to 200 per cent of the member's quota. To reach this amount the country would need *at least* five years, bringing through its purchases of foreign exchange the Fund's holding of its currency at the end of the first, second, third, fourth and fifth year to the equivalent of 100, 125, 150, 175 and 200 million dollars respectively.

We see that the country gains, as a member of the Fund, in our example, the right to purchase 125 million dollars' worth of foreign exchange while it put into the Fund international purchasing power, gold, worth 25 million dollars.

That the total buying rights of the members must be limited goes without saying. The provision that only 25 per cent of the quota can be used up in any one year protects the Fund against quick exhaustion of its scarce currencies and compels the members to take appropriate measures to reestablish equilibrium at an early date, steps which might be unduly postponed if the members could dispose of their buying rights whenever they wanted to.

The Agreement contains, under the unassuming section-title "Charges," an interesting new provision (V-8) to induce

members which are net-purchasers to "consider means" by which the Fund's holdings of their currencies can be reduced.

Aside from the already mentioned uniform service charge (of three-fourths per cent in gold) which a member buying from the Fund has to pay, the Fund will levy charges, uniform for all members, "which shall be payable by any member (in gold) on the average daily balances of its currency held by the Fund in excess of its quota." These charges, which begin at one-half per cent, increase each year according to the duration of such excess and also according to the amount of such excess, this amount being divided into four brackets of 25 per cent each of the member's quota.

Through the combination of these two criteria, duration and amount of the excess, a sensitive index is created for the tardiness of a member in its equilibrating effort.

When the charge has reached four per cent in any bracket (which, of course, will happen much sooner in higher than in lower brackets) "the Fund and the member shall consider means by which the Fund's holdings of the currency can be reduced." When the charges reach five per cent the Fund may impose surcharges as it deems appropriate.

The Fund may in its discretion and on terms which safeguard its interests, waive any of the conditions (V-3) described above, especially in the case of members with a record of avoiding large or continuous use of the Fund's resources (V-4).

Article V-5 states that "whenever the Fund is of the opinion that any member is using the resources of the Fund in a manner contrary to the purposes of the Fund, it shall present to the member a report setting forth the views of the Fund and prescribing a suitable time for reply. After presenting such a report to a member, the Fund may limit the use of its resources by the member. If no reply to the report is received from the member within the prescribed time, or if the reply received is unsatisfactory, the Fund may continue to limit the member's use of the Fund's resources or may, after giving reasonable notice to the member, declare it ineligible to use the resources of the Fund."

The Fund's "views" will, of course, depend on the merits of the case. If we are allowed to follow the provisions of the earlier plans, the report will not only contain a statement of facts but also recommendations to take satisfactory measures. That the Fund may in its discretion waive the conditions (V-3) quoted above, combined with the menacing loss of the buying privileges, may very well induce a member to follow the suggestions of the Fund.

The nature of these suggestions will depend on the special case in question. The Agreement does not contain any general directions and even the somewhat more detailed White and Keynes plans did not inform us about the policies to be followed under given circumstances. Only two exceptions to this statement must be emphasized: all plans, including the Agreement, consider a restoration of equilibrium through an approved change in the exchange rate of a member currency, and all plans, including the Agreement, consider exchange control measures to prevent "use of the Fund's resources to meet a large or sustained outflow of capital" (VI-1). We recall, moreover, that "the Fund shall concur in a proposed change (in the par value) if it is satisfied that the change is necessary to correct a fundamental disequilibrium" and that "in particular, provided it is so satisfied, it shall not object to a proposed change because of the domestic or political policies of the member proposing the change" (IV-5).

This provision suggests that the Fund has no intention to interfere too much with domestic wage and price policies and that the report to the deficit country will probably not contain deflationary recommendations.

That the question of changes in par values and of exchange control are treated in other Articles of the Agreement and not in connection with the report to deficit countries does, of course, not exclude the possibility that the report may concern these policies. But it is not easy to see what measures are to be recommended for more normal deviations from equilibrium, deviations which are not indicative of "fundamental disequilibrium" and are not caused, say, by capital flight, *if our assumption is correct that price, wage, and credit policies would be taboo!*

Since the deficit country may have its own reserves of gold and foreign exchange, the recommendations of the Fund may, of course, concern the use of these reserves.

An extreme suggestion would be to limit imports and this measure could not be a frequently used device in an international organization designed to facilitate the expansion and balanced growth of international trade.

PROVISIONS FOR SURPLUS COUNTRIES

The International Monetary Fund cannot go on indefinitely to sell local currencies since its holdings of any sort of local currency are limited. Aside from the provisions which are aimed at limiting the buying privileges of the members, the Fund may: (1) "require the member (whose currency is scarce) to sell its currency to the Fund for gold" (VII-2-ii); (2) "propose to the member (whose currency is scarce) that . . . the latter lend its currency to the Fund . . . but no member shall be under any obligation to make such loans to the Fund . . ." (VII-2-i); (3) "formally declare such currency scarce and . . . apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent consideration" (VII-3-a); (4) authorize "any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange operations in the scarce currency" (VII-3-b); (5) "issue a report concerning its action" (VII-3-a), a report which, according to the Joint Statement, shall embody the causes of the scarcity and contain recommendations designed to bring it to an end (*Joint Statement* VI-1).

The first two provisions are designed to increase the Fund's stock of scarce currencies. The Fund can use its gold resources to buy additional amounts of local currency. Thus gold has the important function to increase the Fund's liquidity and we shall, therefore, not be surprised to find several provisions which aim at securing a constant reconversion of local currency into gold, gold being the wherewithal or transformer which will protect the Fund against becoming loaded up with unsalable local currencies.

But the gold resources of the Fund (amounting to less than 25 per cent of the aggregate quotas even at the beginning) are far from inexhaustible and the aggregate buying rights of the prospective deficit countries may, therefore, surpass the Fund's resources of local currencies of the prospective surplus countries *plus* its resources of gold.

The borrowing "rights" of the Fund are not to be interpreted to mean that the surplus countries have to loan, if necessary, unlimited amounts of their local currency to the Fund. Only with the consent of the member will the Fund be able to borrow and the member has, therefore, constant control over the total amount of its currency which will be available to other members through the Fund.

The local purchasing power which a member puts at the disposal of the Fund (through subscription or the buying of the Fund's obligations or gold) will, when bought by other members, influence its money market and the demand for its products and must, therefore, be a matter of great concern to its monetary authority. We note that, in contradistinction to the Keynesian scheme, no credit creation by the Fund takes place, so that, over and above its original contribution and the willingness to accept gold for its local currency, the member country, in joining the Fund, has accepted no obligation beyond its own control.

The requirement to sell local currency for gold in any desired amount is not likely to meet any political objections; but it may become an economic nuisance under conditions of full employment, as the discussion in Chapter XI will show.

If the surplus countries are willing to loan sufficient additional amounts of their local currencies to the Fund, the apportioning or rationing of scarce currencies may never become necessary. The prospect that their currency will be rationed may not be pleasant to the countries whose persistently favorable balance of trade has caused the disequilibrium. Rationing would contain dangers of discrimination and would introduce direct controls into the trade relations of the members which may violate the very principle of multilateral clearing. The creditor country, in accepting Article VII-3-b of the Agreement

actually promises "to release other countries from any obligation to take its exports, or, if taken, to pay for them."[4]

The surplus country can help to avoid these temporary inconveniences by loans to the Fund. The rationing provision of the Agreement is only due to the political impossibility to ask for unlimited borrowing privileges for the Fund. Without unlimited power to borrow, but faced with the necessity to meet the buying rights of the members at par, the Fund must have, at least theoretically, the right to apportion scarce currencies. Otherwise the whole system would lack coherence and completeness; it would be subject to the criticism that it makes promises which it may not be able to keep. But while the Fund cannot be granted unlimited borrowing powers at the outset, the members will often be willing to supply additional resources rather than face the inconvenience of having their currencies made subject of exchange control measures or even discriminatory practices throughout the system.

Borrowing and rationing are means to create a temporary and artificial balance but they do not, fundamentally, restore an equilibrium position in which the very causes of the scarcity of the surplus currency are eliminated. This equilibrium has to be approached from the side of the creditor country as well as from that of the debtor country. Since deficit countries which deviate from equilibrium will have presented to them a report setting forth the Fund's views, a similar report should be rendered to surplus countries. The Agreement, unfortunately, has all but eliminated this provision which was strongly emphasized in the original plans and the Joint Statement.

Again we have to ask what these recommendations might contain, and this time we can at least refer to somewhat more explicit suggestions in the earlier plans. The Canadian Plan, e.g., says that the recommendations "may relate to monetary and fiscal policies, exchange rate, commercial policy and international investment" (VI-3).

While the authors of the original plans were unwilling even to mention credit contraction or deflation as appropriate meas-

4. Lord Keynes before the House of Lords on May 23, 1944. He refers to Section VI of the Joint Statement.

ures for deficit countries, they were quite willing to suggest credit expansion as appropriate for surplus countries, provided that there is still room for such policy. This is quite understandable since the whole system aims at expansion and a balanced growth of international trade. It is an attempt to balance imports and exports not by cutting down imports in the deficit countries but by expanding them in the surplus countries, and to achieve the sought for equilibrium position at a high rather than at a low level of employment. This is a development in the right direction. That it is not without dangers is shown in Chapter IX.

Recommendations for the surplus country could concern (aside from requests for loans to the Fund): expansion of foreign investments; domestic credit expansion; upward adjustments of money wages (when out of line with efficiency rates); expansion of imports through reduction of tariffs; and, finally, appreciation of the member's currency. These policies have in common that they would tend to increase imports of commodities and securities. But most of them would meet substantial political opposition. Appreciation would, e.g., be well-nigh impossible for a country with large gold holdings or a substantial gold production. Yet it may be pointed out that the case for appreciation of a surplus currency is, theoretically, just as strong as the case for depreciation of a deficit currency. And since the members are more likely to take the initiative regarding depreciation, appreciation may need the support of the Fund's authority much more. If the Fund's report pointed out that appreciation would help to avoid exchange control it would perhaps be able to overcome the surplus country's reluctance.

LIQUIDITY OF THE FUND'S RESOURCES

Several important provisions aim at the replacement of the local currency holdings of the Fund by gold. The importance of these provisions is obvious: they strengthen the liquidity of the Fund by increasing the shiftability of its resources. The Fund would become increasingly paralyzed if it lost continuously scarce currencies in exchange for currencies for which

there is, at present, no demand. A Fund of unsalable currencies would cease to fulfill its reserve functions. To prevent the accumulation of "dead stock" the Fund is so designed that "local currency" will constantly be sold for gold. Gold is a liquid asset which can, at any time, be turned into any desired currency since all members are obliged to sell their local currency for gold.

The following provisions are designed to ensure a constant replacement of the Fund's local currency resources through gold:

(1) "Any member desiring to obtain, directly or indirectly, the currency of another member for gold shall, provided that it can do so with equal advantage, acquire it by the sale of gold to the Fund" (V-6-a).

(2) "A member may repurchase from the Fund and the Fund shall sell for gold any part of the Fund's holdings of its currency in excess of its quota" (V-7-a).

(3) "At the end of each financial year of the Fund, a member shall repurchase from the Fund with gold or convertible currencies, . . . part of the Fund's holdings of its currency" equal in value to one-half of any increase in the Fund's holdings of its currency that has occurred during the year, "plus one-half of any increase, or minus one-half of any decrease, that has occurred during the year in the member's monetary reserves." [5] But "this rule shall not apply when a member's monetary reserves have decreased during the year by more than the Fund's holdings of its currency have increased" and the repurchase shall not be carried to a point at which the member's reserves would be below its quota or the Fund's holdings of its currency less than the original 75 per cent of the quota (V-7-b).

These provisions leave no doubt that the Fund is always willing to buy gold with local currency at a fixed price and that it prefers on principle gold to holdings of local currency when its holdings of a local currency rise above the level of the original contribution.

5. "A member's monetary reserves mean its net official holdings of gold, of convertible currencies of other members, and of the currencies of such non-members as the Fund may specify (XIX-a).

No explanation is required for the mandatory provisions concerning the repurchase of local currency from the Fund since they are absolutely essential for the constant renewal of the Fund's resources. If no such mandatory provision existed, the Fund could not prevent the member countries from using the Fund's resources whenever they are in need for foreign exchange while the same members could accumulate the gold or foreign exchange which a favorable balance of trade would yield.

Article V-7-a concerning repurchase of a member's currency for gold enables the member to reduce the charges (V-8) on the Fund's holdings of its currency which exceed the quota and, in reducing the Fund's holdings, to increase its right to buy foreign exchange from the Fund since this right depends on the Fund's holdings of the member's currency in relation to the member's quota.

FUND AND GOLD MECHANISM

Until now we have devoted our attention to the equilibrating mechanism of the Fund as it expresses itself in the provisions concerning deficit and surplus countries which depart from equilibrium. These members will be asked to take appropriate measures and whatever these measures may be, they will require deliberate action on the part of the members.

But these provisions should not completely overshadow an equilibrating process which goes on automatically unless it is overcompensated by other forces or consciously interfered with by the monetary authorities of the members. This process is a replica of the old gold mechanism and consists of the effects which the transactions of the Fund will have upon the money, credit, and price systems of the member countries.

When the White and Keynes Plans were first published, Professor Williams suggested that both were "essentially gold standard plans" and that especially the White Plan tried "to preserve as much as possible the previous role of gold." [6]

Applying Professor Williams' suggestions to the Agreement,

6. See John H. Williams, "Currency Stabilization: the Keynes and White Plans," *Foreign Affairs,* July 1943, pp. 649-50.

we can, indeed, find many parallels between the operations of the Fund and the working of the gold mechanism.

(1) The Agreement proposes to express the par value of member currencies in terms of gold or gold dollars and establishes, therefore, the exchange rates very much in the same way as if all the members were on the gold or gold exchange standard.

(2) Gold movements are not necessary but their function is preserved and performed by currency transfers in the Fund.[7]

(3) "These transfers in the Fund . . . affect bank reserves in precisely the same manner as the movement of gold under the gold standard"[8] and may, therefore,

(4) "have the same monetary and price effects as under the gold standard."[9]

Thus any member which becomes a net purchaser from the Fund is in a position similar to that of a gold losing country; and any surplus country is in a position similar to that of a gold receiving country. Incidentally, the deficit country may actually lose gold according to the repurchase provision; and the surplus country may actually receive gold under the provision which entitles the Fund to sell gold to a member in exchange for the member's currency.

Let us assume that a deficit country (a net purchaser) buys foreign exchange from the Fund. The buyer is the member's Central Bank which will sell the acquired foreign exchange to its member banks which, in turn, will sell it to their customers. This process will reduce the member banks' demand deposits and their reserve deposits with the Central Bank by an equal amount and, since the member banks are obliged to hold only a fractional reserve against their demand deposits, their reserve position will, clearly, be weakened. If the member banks did not have excess reserves and if the Central Bank (which might be losing gold at the time) would not make additional reserves available, credits would have to be contracted with deflationary effects on employment, national income, prices and imports.

The opposite would be true in a surplus country. Foreign exchange received from net exports would be sold to the Central

7. *Ibid.* 8. *Ibid.* 9. *Ibid.*

Bank with the effect that both the demand deposits of the commercial banks and their reserve deposits with the Central Bank would be increased by the same amount, thus improving the commercial banks' reserve position and, consequently, enabling credit expansion.

Of course, there is no compelling reason to assume that the credit expansion would actually take place. Decreasing rates of interest may not be able to induce additional private investment and it is easily possible that the whole effect will exhaust itself in a further increase in excess reserves and in the gold holdings of the Central Bank. We should remember that the theory of the expansionist effects of a gold inflow requires that the surplus countries should not have too much gold and that the Fund does not attempt a general redistribution of gold.

Closest scrutiny of the original plans, the Joint Statement or the new Agreement will not reveal a single provision or hint or implication that net purchasers of foreign currency are supposed to let these purchases have the deflationary effects which they were expected to have according to the gold standard analogy. Rather it appears as almost certain that the different plans were designed to obliterate this part of the gold mechanism or, at best, to let it operate only under control and therefore not automatically.

No objections seem to exist concerning the other half of the gold mechanism: the credit expansion of the surplus countries. But it seems to be the opinion of the experts that we cannot rely on the automatic forces of expansion and are, therefore, compelled to do something about it.

ORGANIZATION AND MANAGEMENT

The Fund has a Board of Governors, Executive Directors, a Managing Director and a staff (XII-1). The Board of Governors, in which all powers are vested, consists of one governor and one alternate appointed by each member. The Board has the power to admit new members, to approve a revision of quotas, to approve a uniform change in the par value of the currencies of all members, to require a member to withdraw, and to decide to liquidate the Fund (XII-2).

The Executive Directors are responsible for the conduct of the general operations of the Fund and for this purpose exercise powers delegated to them by the Board. There shall be no less than twelve directors (who need not be governors). Five directors are to be *appointed* by the five members having the largest quotas (United States, United Kingdom, Union of Soviet Socialist Republics, China and France), two shall be *elected* by the American Republics not entitled to appoint directors, five by other members not entitled to appoint directors. Two more directors are possibly appointed by the two members the holdings of whose currencies by the Fund have, on the average of the preceding two years, been reduced by the largest amount, provided that these members are not yet included in the five members with the biggest quotas. The Executive Directors shall function in continuous session. Each appointed director shall be entitled to cast the number of votes allotted to the member appointing him and each elected director shall cast the number of votes which counted towards his election (XII-3).

The Executive Directors select a Managing Director who shall not be a governor or an executive director. The Managing Director shall be chairman of the Executive Directors but shall have no vote except a deciding vote in case of an equal division. He is chief of the operating staff and conducts the ordinary business of the Fund.

The voting rights of the members depend in the main on their quotas. Each member has 250 votes plus one additional vote for each part of its quota equivalent to $100,000, adjusted by an addition of votes for net sales of its currency by the Fund and a subtraction of votes for net purchases of foreign exchange from the Fund amounting to one vote for each $400,000 of such sales or purchases up to the date when the vote is taken, but neither net sales nor net purchases shall be deemed at any time to exceed the member's quota (XII-5).

VII.

THE KEYNESIAN INTERNATIONAL CLEARING UNION

THE CREATION OF INTERNATIONAL BANK MONEY

THE KEYNES PLAN will be discussed despite the publication of the Agreement for the following reasons: *First,* knowledge of the Keynes Plan is necessary for the fuller understanding of the Agreement, which, while it did not choose the Keynesian approach, is, nevertheless a compromise product quite visibly influenced by Lord Keynes; *second,* the Keynes Plan will be indicative of the British attitude when the International Monetary Fund will have to develop its policies; *third,* the Keynes Plan, unlike the White Plan or the Agreement, makes the intentions of each of its proposals clear and contains, therefore, most valuable explanatory material; *fourth,* the structure of the Keynesian scheme is so beautiful in its elegance and simplicity that our understanding of the problems of multilateral clearing will gain from a study of its mechanism.

This chapter merely aims at a survey of the working principles of the International Clearing Union, whose main problems will be discussed in the following chapters, often by way of comparison with the International Monetary Fund.

The Keynes Plan proposes "to establish . . . an *International Clearing Union,* based on international bank-money, called (let us say) *bancor,* fixed (but not unalterably) in terms of gold and accepted as the equivalent of gold by the British Commonwealth and the United States and all the other members of the Union for the purpose of settling international balances. The Central Banks of all member States (and also of non-members)

would keep accounts with the International Clearing Union through which they would be entitled to settle their exchange balances with one another at their par value as defined in terms of bancor. Countries having a favorable balance of payments with the rest of the world as a whole would find themselves in possession of a credit account with the Clearing Union, and those having an unfavorable balance would have a debit account. Measures would be necessary . . . to prevent the piling up of credit and debit balances without limit, and the system would have failed in the long run if it did not possess sufficient capacity for self-equilibrium to secure this" (*Keynes Plan* I-4).[1]

The provisions of the Keynes Plan concerning the determination of exchange rates and quotas will be discussed in the chapters following. At present it suffices to know that each member State's quota limits "its right to enjoy the credit facilities provided by the Union" (*Keynes Plan* II-6-5).

We see that the International Reserve Bank of the Keynesian brand unlike the Fund *creates* its own resources. The underlying idea is simple, namely, "to generalise the essential principle of banking as it is exhibited within any closed system. This principle is the necessary equality of credits and debits. If no credits can be removed outside the clearing system, but only transferred within it, the Union can never be in any difficulty as regards the honoring of cheques drawn upon it. . . . Its sole task is to see to it that its members keep the rules and that the advances made to each of them are prudent and advisable for the Union as a whole" (*Keynes Plan* I-5).

Instead of making capital contributions to the Clearing Union, the member States are simply asked to "agree to accept payment of currency balances, due to them from other members, by a transfer of bancor to their credit in the books of the Clearing Union"; and instead of becoming net-purchasers of

1. Cf. Robertson, *op. cit.*, p. 359: "It is arguable that the proudest day in the life of the Manager of the Clearing Union would be that on which, as a result of the smooth functioning of the correctives set in motion by the Plan, there were *no* holders of international money—on which he was able to show a balance sheet with zero on both sides of the account."

foreign exchange, the member countries are entitled, subject to certain conditions, "to make transfers of bancor to other members which have the effect of overdrawing their own accounts with the Union, provided that the maximum debit balances thus created do not exceed their quota" (*Keynes Plan* II-6-6).

We see that the Keynes Plan makes use of the overdraft principle which is, to follow Lord Keynes's own description, a British "practice of economising the amount of cash deposits." Overdraft is "an arrangement with the bank that an account may be in debit at any time up to an amount not exceeding an agreed figure." The distinction between demand deposits and overdraft facilities is simply that "a customer of a bank may draw a cheque against his deposit, thus diminishing his *credit* with the bank" while "he may, equally well, draw a cheque against his overdraft, thus increasing his *debit* with the bank." [2]

Now we see international bank money in its pure form coming to life whenever a country makes use of its overdraft privileges. It will, then, have a debit account with the International Clearing Union, and this debit account must be balanced by a corresponding credit account of other countries with the Union. It is easy to see that a credit has been given by the country with the credit balance to the country with the debit balance.

Let us again assume that the Banque de France needs dollar balances. Instead of buying dollars from a Fund, as in the case of the Agreement, it would make a transfer of bancor to the Federal Reserve Bank's account, thus overdrawing its own account with the Clearing Union and receiving, actually, a credit from the Federal Reserve Bank. The effect of the transaction would again be similar to that of a flow of gold from France to the United States. Since France imported more than she exported, the commercial banks and exchange dealers, in

2. J. M. Keynes, *A Treatise on Money* (New York, Harcourt, Brace and Company, 1930), I, 41-43. See also Robertson, *op. cit.*, p. 358: "... the difference between the loan proper and the overdraft—between borrowing money before you need to use it and not borrowing it until you need to use it—is really a very narrow and technical one; the former would, I believe, seem as perverse and unnatural to a Scotchman as the latter apparently does to an American."

procuring foreign exchange from the Banque de France will weaken the reserve position of the commercial banks, while the selling of foreign exchange to, or the depositing of dollars with, the Federal Reserve Bank by commercial banks in the United States would increase member bank reserves.

THE EQUILIBRATING MECHANISM

Obviously the Keynes Plan must contain provisions which will prevent an unlimited piling up of deficit and credit balances by member States. The idea of a symmetrical treatment of debtor and creditor countries is strongly emphasized by the Keynes Plan, though, as we shall see not consistently maintained. Indeed, while Lord Keynes does not lay claim to originality concerning his proposals in general (*Keynes Plan* I-2), he finds that "in recognising that the creditor as well as the debtor may be responsible for a want of balance, the proposed institution would be breaking new ground" (*Keynes Plan,* Preface).

Both the creditor and the debtor countries are subject to the provision that "a member State shall pay to the Reserve Fund of the Clearing Union a charge of 1 per cent. per annum on the amount of its average balance in bancor, whether it is a credit or a debit balance, in excess of a quarter of its quota; and a further charge of 1 per cent. on its average balance, whether credit or debit, in excess of a half of its quota. Thus, only a country which keeps as nearly as possible in a state of international balance on the average of the year will escape this contribution. These charges are not absolutely essential to the scheme. But if they are found acceptable, they would be valuable and important inducements towards keeping a level balance, and a significant indication that the system looks on excessive credit balances with as critical an eye as on excessive debit balances, each being, indeed, the inevitable concomitant of the other" (*Keynes Plan* II-6-7).

The Keynes Plan furthermore suggests that any member State in debit may borrow bancor from the balance of any member State in credit, "by which means each would avoid these contributions" (II-6-7) while the debtor country would get at least part of its overdraft privileges back.

The proposed tax would, of course, be much too feeble an instrument to maintain an international payment equilibrium. More potent weapons are, therefore, provided by the Keynes Plan.

PROVISIONS FOR DEFICIT COUNTRIES

The provisions concerning the deficit countries refer to the size of the debit balances in relation to the countries' quotas and to the time period during which the debit balances have been unusually large and include permissions, recommendations, requirements, requests and, *sit venia verbo*, punishments.

Since these provisions (II-6-8) are of the greatest importance for the working of the plan, we quote them in full:

(a) "A member State may not increase its debit balance by more than a *quarter* of its quota within a year without the permission of the Governing Board. If its debits balance has exceeded a quarter of its quota on the average of at least two years, it shall be entitled to reduce the value of its currency in terms of bancor provided that the reduction shall not exceed 5 per cent. without the consent of the Governing Board; but it shall not be entitled to repeat this procedure unless the Board is satisfied that this procedure is appropriate."

(b) "The Governing Board may require from a member State having a debit balance reaching a *half* of its quota the deposit of suitable collateral against its debit balance. Such collateral shall, at the discretion of the Governing Board, take the form of gold, foreign or domestic currency or Government bonds, within the capacity of the member State. As a condition of allowing a member State to increase its debit balance to a figure in excess of a half of its quota, the Governing Board may require all or any of the following measures:—

(i) a stated reduction in the value of the member's currency, if it deems that to be the suitable remedy;
(ii) the control of outward capital transactions if not already in force; and
(iii) the outright surrender of a suitable proportion of any separate gold or other liquid reserve in reduction of its debit balance.

Furthermore, the Governing Board may recommend to the Government of the member State any internal measures affecting its domestic economy which may appear to be appropriate to restore the equilibrium of its international balance."

(c) "If a member State's debit balance has exceeded *three-quarters* of its quota on the average of at least a year and is excessive in the opinion of the Governing Board in relation to the total debit balances outstanding on the books of the Clearing Union, or is increasing at an excessive rate, it may, in addition, be asked by the Governing Board to take measures to improve its position, and, in the event of its failing to reduce its debit balance accordingly within two years, the Governing Board may declare that it is in default and no longer entitled to draw against its account except with permission of the Governing Board" (*Keynes Plan* II-6-8).

We see that the provisions of the Keynes Plan which are addressed to deficit countries are similar to those of the Agreement. The degree of similarity is further increased when we add exchange depreciation to the equilibrium mechanism. The International Monetary Fund permits changes in the par value of the currency of a deficit country "if it is satisfied that the change is necessary to correct a fundamental disequilibrium" (Agreement IV-5). It should be noticed that, as in the Agreement, the nature of Lord Keynes's recommendations concerning "internal measures" remains entirely vague.

PROVISIONS FOR SURPLUS COUNTRIES

Concerning the measures appropriate for a creditor country to restore equilibrium in its balance of payments, the Keynes Plan is not equally bashful—thus marring somewhat the plans "symmetric" structure.[3]

The provisions concerning creditor countries read as follows:

"A member State whose credit balance has exceeded *half* of its quota on the average of at least a year shall discuss with the Governing Board (but shall retain the ultimate decision

3. For a discussion of this point see below, Chapter VIII.

in its own hands) what measures would be appropriate to restore the equilibrium of its international balances, including

(a) Measures for the expansion of domestic credit and domestic demand.

(b) The appreciation of its local currency in terms of bancor, or, alternatively, the encouragement of an increase in money rates of earnings.

(c) The reduction of tariffs and other discouragements against imports.

(d) International development loans" (*Keynes Plan* II-6-9).

In the following chapters we shall have frequent opportunity to compare the provisions of the Keynes Plan with those of the Agreement. Since both aim at the same goal, it is not surprising that they are, basically, very much alike. Only in one respect do the plans diverge considerably.

According to the Agreement the International Monetary Fund can only sell what it received as a contribution (in national currencies and gold) and what it was able to buy and borrow. The prospective creditors among the member countries know, therefore, how much of their local purchasing power will be available to other countries. Gold resources of the International Monetary Fund too, will have to be considered as potential purchasing power which may be spent on the surplus countries' markets. Generally speaking, however, the surplus countries' contributions to the international exchange pool are meant to remain in the neighborhood of their own individual quotas.

In this respect the Keynes Plan leads to different results. If we make the extreme assumption that only one creditor country exists among all the member States of the Clearing Union and that all the deficit countries make use of their overdraft privileges, the credit balance of the creditor country might (theoretically) amount to three quarters of the sum of all quotas (minus the quota of the creditor country itself).

VIII.

QUOTAS AND CREDITORS

QUOTA FORMULAE

THE AGREEMENT makes the subscription of members to the International Monetary Fund (III-3), their buying rights (V-3), and their voting powers (XII-5) dependent on their quotas. Despite this threefold function of the quotas, however, the Agreement says nothing about the formula according to which the quotas are determined. We hear that each member "shall be assigned a quota" and we find the quotas of the "original members" in Schedule A of the Agreement. We are also informed that the quotas of other members "shall be determined by the Fund" (III-1), that "the Fund shall at intervals of five years review, and if it deems it appropriate propose an adjustment of, the quotas of the members" (III-2), and that it shall consider the adjustment of any particular quota at any time at the request of a member. But "a four-fifths majority of the total voting power shall be required for any change in quotas and no quota shall be changed without the consent of the member concerned" (III-2).

These are important technical provisions and decisions, but they do not satisfy our curiosity. How were the quotas of the original members arrived at? Even though we know that the quotas of Schedule A are the result of political concessions, we may assume that the quotas, as originally proposed, resulted from the application of a formula similar to the one suggested in the White and Canadian plans. This formula "gives due weight to the important relevant factors, e.g., a country's holdings of gold and free foreign exchange, the magnitude and the

fluctuations of its balance of international payments, its national income, etc." (*White Plan* II-4).

To understand the combination of these rather heterogeneous factors in one quota formula we have not only to consider the threefold function of the quotas but also the important fact that the members cannot be classified *a priori* as either surplus or deficit countries. The formula must, therefore, be so chosen that the calculated quotas fit reasonably well the members' economic significance, their ability to subscribe, and their need for foreign exchange.

The aggregate of quotas, moreover, must be such that the main purposes of the Fund can be achieved.

The national income of a member country indicates its wealth and, therefore, its ability to contribute to the common Fund; it also is a good index for the member's economic significance.

The magnitude and the fluctuations of a country's balance of payments are an excellent indicator of a country's need for foreign exchange and should, therefore be used in determining a member's quota, i.e. its right to buy foreign exchange from the Fund.

A member's holdings of gold and gold-convertible exchange is an indication of its ability to contribute gold, the Fund's most liquid asset, with which, in case of need, scarce currencies can be bought.

The political concessions which led to deviations from the formula were either due to reasons of prestige (France's inclusion into the "Big Five") or to the very plausible argument that post-war potentialities rather than conditions of the past should be decisive.

The Keynes Plan suggested a very simple formula according to which the quotas would have been fixed as 75 per cent of the sum of each country's exports and imports on the average of (say) the three pre-war years with special assessments in cases where this sum would for any reason have been inappropriate (*Keynes Plan* II-6-5).

The difference between the quota formulae of the White and Keynes plans led some superficial readers to the conclusion

that the United States Treasury chose gold holdings and national income as "relevant factors" in order to acquire a predominant influence in the administration of the Fund, while the British Plan overemphasized international trade in order to secure an overrepresentation of the British Empire.

That the two original plans chose different quota formulae was, however, easily explained by the different function of the quotas in the two schemes. According to the White Plan and the Agreement the Fund's supply of member currencies rests mainly on the members' contributions. If, therefore, the Treasury of the United States favors a formula according to which it will receive a high quota, it shows a willingness to contribute a greater share to the common exchange or credit pool. We misunderstand the function of quotas in the White Plan and in the Agreement if we see in them nothing more than the right to purchase foreign exchange at a fixed rate from the Fund. It is, therefore, by no means "paradoxical to make the extent of access to borrowing facilities depend in part on the evidence of the lack of need for it," as Professor Viner thinks,[1] once we comprehend that the quotas of the White Plan and of the Agreement are designed for surplus countries as well as for deficit countries.

In the Keynes Plan the same formula would make much less sense since, according to the Keynes Plan, international currency is simply created *ad hoc* to the amount to which the deficit countries make use of their overdraft privileges and is not dependent on the surplus countries' contributions.

AGGREGATE OF QUOTAS

The aggregate of quotas of the original members of the Fund amounts to 8.8 billion dollars. This corresponds to an aggregate of about 11 billion dollars for the world as a whole.

Is this amount small or large, insufficient or dangerously inflationary? Only experience will be able to tell. The figure has been chosen in the belief that, according to the fluctuations in international trade during the immediate pre-war years, a

1. Jacob Viner, "Two Plans for International Monetary Stabilization," *Yale Review*, Autumn 1943, p. 91.

Fund of this size could have handled rather comfortably the debit balances on current account in those years.

The emphasis on *current account* is, of course, of great importance. The financing of capital flight movements, of relief and rehabilitation, of reconstruction and development, is expressly excluded from the operations of the Fund. But whether pre-war and post-war figures are at all comparable remains doubtful. The pre-war figures are distorted by the influence of exchange control and its artificial way of balancing international payments. And post-war debit balances on current account are unpredictable considering the enormous dislocations which the war will have brought about in international trade relations.

Another important factor in the determination of quotas is the leeway we want to give to the members in their domestic policies. The size of a reserve of international money depends on the promptness or the delay with which balance of payments disequilibria are eliminated. This is perhaps the most important point of all.

The aggregate of quotas is not identical with the quantity of foreign exchange at the disposal of the Fund. While all contributions are, indeed, a *potential* supply of foreign exchange, the local currency of the deficit countries is bound to stay with the Fund whose holdings of currencies of deficit countries will tend to increase as the deficit countries buy the currencies of the surplus countries from the Fund. Rather the *true* supply of foreign exchange by the Fund consists either of gold or of the currencies of the surplus countries which the Fund happens to command. And this supply comes from the gold contributions of the members, from the contributions of their local currencies by surplus countries, from loans by members to the Fund, and from purchases of gold and gold-convertible exchange by the Fund from members.

Since the aggregate of quotas is to be the equivalent of 8.8 billion dollars and since the Fund's resources of the currencies of deficit countries have to be deducted as momentarily irrelevant, the maximum supply of foreign exchange by the Fund would be rather narrowly limited were it not for the elastic

provision that the Fund has the right "to propose" to the members that they should lend their currencies to the Fund (VII-2). Purchases by the Fund of gold and gold-convertible exchange from members would have the advantage of increasing the liquidity of the Fund and would, in this sense, amount to a virtual increase in the Fund's supply of foreign exchange.

According to the Keynes Plan foreign money is *created* whenever a country makes use of its overdraft privileges. The potential supply of international bank money which could be created is, therefore, equal to the sum of the overdraft privileges of the deficit countries: a huge sum which, it will be remembered, is identical with the potential credit balances of the surplus countries. The potential quantity of foreign money in the Keynes Plan seems, therefore, to be many times larger than the supply of international currency under the Agreement. But it would be unfair to criticize the Keynes Plan too much on the basis of the rather formidable sum of money which would follow from extreme assumptions as to the number of deficit countries (all members minus one) and as to the unimpeded use these deficit countries would make of their overdraft privileges. The Keynes Plan, in fact, already anticipated this criticism by the statement that "the system would have failed in the long run if it did not possess sufficient capacity for self-equilibrium to . . . prevent the piling up of credit and debit balances without limit" (*Keynes Plan* I-4). Quite obviously, Lord Keynes does not consider the aggregate quotas of the deficit countries as a safety zone within which the International Clearing Union could have operated *ad libitum.*

The quota formula of the Keynes Plan would have led to a rather formidable potential supply of international bank money. "The average of world trade (imports *plus* exports of merchandise) for the three pre-war years was 48,000 million dollars. Thus, if all the world joined the Clearing Union, the sum of quotas would be 36,000 million dollars (if only the United and Associated Nations and their dependencies are included, the total is reduced by about 10,000 million dollars). If all countries except one are imagined to be drawing on their quotas, it is natural to imagine that the exception is the United

States. The U.S.A. quota would be 3,000 million dollars. Thus the upper limit which the debit account of the world might reach is three-quarters of 33,000 million dollars, that is, about 24,000 million dollars, though correctives would come into play before 8,000 million dollars had been reached." [2]

Such estimates are easy enough to make, but it is impossible to predict how much of this potential international bank money would actually have been created per period and against how many surplus countries this purchasing power would have been directed. It remains surprising, however, that according to the Keynes Plan 8 billion dollars would barely have begun to set in motion the equilibrating mechanism while 8.8 billion dollars are the aggregate quota of the Agreement. The Keynes Plan could, conceivably, have resulted in an additional demand for commodities in the United States of several billion dollars *per annum,* owing to an extensive use, if not misuse, by deficit countries of their overdraft privileges; while the total United States quota under the Agreement is 2.75 billion dollars.

CREDITOR RESPONSIBILITIES

The Keynes Plan is, admittedly, unsymmetrical in its treatment of debtor and creditor countries. The debtor countries have ample, but definitely limited, overdraft privileges and "counter-measures are called for long before the maximum is reached." But "in case of credit balances no rigid maximum has been proposed" (*Keynes Plan* III-7). The explanation is quite simple: since debit and credit balances must always be equal in the Keynesian scheme, the creditor countries must be willing to accumulate credit balances to the very amount to which the debtor countries avail themselves of their overdraft privileges. If a rigid maximum for credit balances were proposed and if the debit balances were tending to grow beyond that limit, the creditor countries would have to be forced into "compulsory investment of persistent bancor credit balances" to make room for new debit-credit balances (*Keynes Plan* III-7).

2. See Robinson, *op. cit.,* p. 165. For similar estimates, cf. Viner, *op. cit.,* p. 88; Williams, *Foreign Affairs,* July 1943, p. 652; Neisser, *op. cit.,* p. 276.

The Agreement leads to different results. Since the International Monetary Fund cannot create credit, its resources of any one country's currency are flexible but limited. A creditor (surplus) country will, owing to the operations of the Fund, not have directed against its markets more purchasing power than (a) the Fund's holdings of the country's local currency; (b) the Fund's gold resources; and (c) what additional local currency the country is willing to lend to the Fund. This total amount is either very much smaller than the total credit creation capacity of the Keynesian Clearing Union or else is under control (through lending operations) of the surplus country's monetary authority.

To repeat: not only is the aggregate of the quotas much larger in the Keynes Plan but nearly the full amount of all overdraft privileges taken together could, theoretically, become the credit balance with the Clearing Union of one surplus country. The Agreement is not only much more modest in the aggregate of quotas but limits the obligations of each potential surplus country to the country's contribution of local currency *plus* its readiness to accept gold for its local currency. The surplus country's credit creation and lending policies remain exclusively a function of its monetary authority.

This is the most decisive difference between the Agreement and the Keynes Plan and we can, in all probability, attribute the choice of the White-Canadian approach in the Agreement to its greater moderation in the determination of the potential obligations of the surplus countries. The Keynesian scheme would amount to indirect compulsion to create and extend credit whenever a deficit country makes use of its overdraft privileges. According to the Agreement additional resources of local currency of a surplus country could only be secured through borrowing by the Fund from the country, an operation which obviously would be subject to the decisions of the monetary authorities of the surplus country.

No doubt, prospective surplus countries will be more willing to enter an international agreement in which they remain masters of their right to create credit. The Keynes Plan, on the

other hand, had the technical advantage of creating international bank money according to "the needs of international trade" within very generous limits and without having to bother with the rationing of scarce currencies. In refusing to set rigid maxima for credit balances the Keynes Plan was formally consistent. The Agreement is not equally consistent, since the rights of the deficit countries to buy the currencies of the surplus countries from the Fund may easily be greater than the supply of these currencies by the Fund. The Fund may, consequently, be forced into rationing, a solution which always indicates that normal methods of maintaining equilibrium between demand and supply are not available.

CRITICISMS CONCERNING THE TREATMENT OF CREDITORS

The treatment of the creditor countries in the three original plans and in the Joint Statement has been widely criticized, especially in the United States. The basic argument is that the plans, but especially the Keynes Plan, have the object to make the United States the milch cow of the world—a charge for which there is no foundation according to Lord Keynes.[3]

We shall enumerate these criticisms and, then, try to evaluate their merits.

(1) According to Professor Anderson the plans put international lending into the hands of the debtors. "Strong and weak alike, debtor and creditor alike, pool their resources *and the debtors decide how to lend them.*" Professor Anderson calls this "an unnatural and an unsound arrangement in principle" since "if credits are to be safe, the creditor must be in a position . . .

3. House of Lords, May 18, 1943. See Robinson, *op. cit.*, p. 165. Louis Rasminsky believes "that far from desiring to obtain from the United States anything which by the remotest stretch of imagination could possibly be construed as a "hand-out," there is almost no length to which self-respecting foreign countries would not go in order to avoid this. . . . The real danger, so far as the more responsible foreign countries are concerned, is not that they will wish to raid the American pantry but that they will be so anxious to avoid any suspicion of such an intention that they will be hesitant to count on the permanence of that degree of American cooperation which is willingly offered."—"International Credit and Currency Plans," *Foreign Affairs*, July 1944, pp. 590-91.

to impose conditions that will make the credit safe."[4] Professor Viner, too, considers "unrestricted borrowing rights for member countries regardless of their credit worthiness" as "a situation which is without precedent ... in the financial field, whether private or public, national or international."[5]

(2) The creditor countries, we are told, should at least know what they are in for. A plan which does not set rigid maxima for the obligations of the surplus countries cannot possibly be accepted because the creditor countries will at least want to know how much lending, exporting, and producing they will be obliged to do. This is a problem of eminent importance for their domestic economies, especially in the immediate post-war period. The impact of practically unrestricted foreign buying, it is claimed, would make it most difficult, if not impossible, to control the inflationary forces of the transition period.[6]

(3) Looking somewhat farther into the future, the creditor countries have to plan for the time when they will have to change from an export surplus to an import surplus. Mr. de Vegh has pointed out that "this change-over from an export surplus to an import surplus will be painful enough after the American economy will have been geared to so large an export surplus for so long a time," but that the change will be made even more difficult by the fact "that the squeeze on our external trade will come at the very time when domestic demand will probably begin to peter out."[7]

(4) Some observers think that the three original plans, but especially the Keynes Plan, are psychologically deficient. The Economic Policy Commission of the American Bankers Association, e.g., comes to the conclusion that "a system of quotas or shares in a pool which gives debtor countries the impression that they have a *right* to credits up to some amount is unsound in principle, and raises hopes that cannot be realized. Such a

4. Benjamin M. Anderson, *Postwar Stabilization of Foreign Exchange,* Economists' National Committee on Monetary Policy (New York, May 1943), p. 23.

5. Viner, *op. cit.,* pp. 89-90.

6. See, e.g., Williams, *Foreign Affairs,* July 1943, p. 653.

7. See Imre de Vegh, "The International Clearing Union," *American Economic Review,* September, 1943, p. 541.

system would encourage the impression that credits received may not have to be liquidated, and would invite abuses of the facilities." [8] Professor Williams believes that it would be a weakness of the Keynes Plan that "it might well seem to many of the member countries like getting something for nothing, since nothing has to be put up" and that "there might easily develop a strong urge for bigger and better quotas all around." [9] There are, of course, restrictions built into the plans which are to prevent abuses of the borrowing privileges of the debtor countries. But Mr. de Vegh reminds us that "to make billions of bancor available to the governments of the needy countries . . . and then to take action to cut down imports so obviously needed and just placed within the reach of these governments, will take superhuman wisdom, force, and courage on the part of the Board of Governors of the Clearing Union." [10]

(5) We are further told that the plans overemphasize the responsibilities of the creditor countries and that they are not more but less symmetrical than the old gold standard mechanism. Under the gold standard mechanism the debtor countries had to bear at least half of the adjustment burden through credit contraction. Under the new plans which eulogize credit expansion, "the ultimate responsibility for a continued disequilibrium rests on the creditor." [11] The creditor country is told to lower tariffs, to increase wages, to expand credit, to appreciate its currency, or to lend on long-term at a rate equivalent to its surplus. But equally precise rules of behavior are not given to debtor countries—the term credit contraction, in particular, is most carefully avoided.

(6) It is also contended that the creditor countries will not profit under the new schemes as creditors should profit. The creditor countries would get in return for exported commodities a share in an international fund or pool diluted by the bad

8. *Place of the United States in the Post-War Economy,* Report by the Economic Policy Commission, American Bankers Association, September 1943, pp. 14-15.

9. Williams, *Foreign Affairs,* July 1943, p. 649.

10. Imre de Vegh, *op. cit.,* p. 540.

11. M. Palyi, "Some Implications of the Keynes-Morgenthau International Clearing Pool," *Great Lakes Banker,* July, 1943.

currencies of the deficit countries. And, far from earning interest, this share in the international pool, if thought excessively large, would cost the lending country, according to the Keynes Plan, a charge of one or two per cent—a situation which Professor Anderson characterizes as "utterly grotesque." [12]

(7) The quotas of the plans are considered as too large for mere reserve balances, i.e., when relief and reconstruction are excluded from the domain of the International Reserve Bank. Since the balances are too large for reserve purposes, and owing to certain psychological deficiencies of the plans (see above point 4), it seems to some observers that "the credit extensions to be granted . . . would tend inevitably to become long-term in character," and that "credit extensions of this character should be handled by other agencies." [13]

(8) Finally, the opposition deteriorates somewhat into open accusations in claiming that the new plans result in the redistribution of wealth in favor of countries which consume more than they produce.[14]

This opposition to the new plans, and in particular to the Keynes Plan, is quite natural. Lord Keynes himself considers the recognition of the creditor countries' responsibilities as the only point where his proposed institution would be breaking new ground. It is not at all surprising, therefore, that this should be the point where Lord Keynes will find it hardest to convince his opponents.

BORROWING RIGHTS AND RESERVES

Before we try to disprove part of the above listed criticisms, it is advisable that we should emphasize once more that the creditor countries do not join an international monetary system as benefactors but rather in their own self-interest.

This can best be shown in a brief analysis of what would happen in the deficit countries after the war if they were left

12. B. Anderson, *op. cit.*, p. 26.
13. W. W. Aldrich, *The Problem of Post-War Monetary Stabilization* (April 1943), p. 7.
14. See Palyi, "Some Implications," *loc. cit.*

to themselves without adequate reserves of international money.[15]

In the absence of an international monetary system such as proposed in the Agreement, the deficit countries would have to try to reach international payment equilibrium in one of two ways. They would either have to increase their exports or they would have to cut down their imports.

To increase their exports they could try to follow the recipe of the gold mechanism and deflate their national currencies, a policy which would mean decreasing expenditure, employment and national income, with a fair chance that these depressive tendencies would prove contagious for the creditor countries. Or the deficit countries could use competitive exchange depreciation as a stimulant—a method equally undesirable from the standpoint of the surplus countries.

To cut their imports down to the level of their exports, the deficit countries would use cumulative protection and exchange control measures and this would most certainly create a situation for the creditor countries which would be worse than anything that could possibly result from the transactions of the International Monetary Fund.

The argument that the creditor countries would be obliged to grant borrowing rights without consideration of credit worthiness can only be maintained in a purely formal sense. It certainly does not prove that indirect lending is always inferior to direct lending. Four important points should be considered in this respect.

(1) As the debtor countries make use of their buying rights or overdraft privileges they are subjected to increasing pressure by the International Monetary Fund (Clearing Union) to adopt policies which are designed to help to restore international payment equilibrium.

(2) While the creditor countries cannot consider an individual deficit country's credit worthiness, nevertheless some diversification of risk is offered by the International Monetary Fund (or the Clearing Union).

15. See the excellent analysis by Louis Rasminsky in *Foreign Affairs,* July 1944, pp. 592-93.

(3) The creditor countries will, in their own long-run interest, grant foreign loans anyhow. To segregate part of these loanable funds for the setting up of an international monetary institution would help to create the very foundation for sound international lending.

(4) "The creditor has greater freedom of action in obtaining repayment under a genuinely international monetary system than he has under a monetary system bolstered by bilateral credit deals. For the latter will tend . . . to bilateral trade deals. In such circumstances the creditor can obtain repayment only by increasing his imports *from the country to which he has extended credit;* in a truly international system, such as contemplated by the Fund proposals, he can obtain repayment by increasing his imports *from any part of the world.*"[16]

It is true that too much international purchasing power directed too soon against the markets of the creditor countries would entail grave inflationary dangers. That Lord Keynes is aware of this is shown in section X-42 of his plan in which he suggests the replacement of the proposed overdraft facilities during a "relief" period of (say) two years by relief aid and reconstruction. But we may still contend, of course, that the total overdraft facilities of all debtor countries would be a source of inflationary danger even in normal times. It is partly for this reason, we may presume, that the Agreement followed the proposals of Dr. White rather than those of Lord Keynes.

Those who would maintain that even the Agreement is full of inflationary dangers and is putting too heavy a burden on the shoulders of the prospective creditor countries should tell us how we could safely dispense with an international organization like the International Monetary Fund (or the Clearing Union) even if such organizations contain (as any Central Banking System) inflationary possibilities.

In both the Agreement and the Keynes Plan the quotas are considered as reserves of international money which, according to the Agreement, aim "to give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct

16. See Rasminsky, *op. cit.*, p. 594.

maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (*Agreement* I-v; *Joint Statement* I-3; see also: *White Plan*, Preamble 3; *Canadian Plan*, General Observations 10; *Keynes Plan* IV-16 and VII-36). These reserves of international money are to furnish the elastic link which is quite indispensable if we want to stabilize exchange rates and intend, at the same time, to give considerable freedom of action to the member countries.

Both the Agreement and the Keynes Plan emphasizes the necessity of policies which make for an orderly return to international payment equilibrium if equilibrium should be disturbed by divergent domestic credit policies in the different member countries. But the plans stress, also, the importance of allowing enough time for these adjustments. The implication is, obviously, that exchange stabilization must not be achieved at the price of quickly enforced deflation in the deficit countries and inflation in the creditor countries. Time has to be allowed for an orderly return to equilibrium.

The availability of adequate reserves of international money is, therefore, quite indispensable for the functioning of a modern international payment mechanism which rests on the realistic assumption that occasional temporary divergencies in the different domestic credit policies of the member countries are unavoidable.

The aim of a policy of international integration of national economic stabilization policies is so ambitious and so complicated that we cannot be surprised that the experts differ widely as to the amount of freedom which should be given to the member countries and, consequently, as to the breathing space which should be permitted for necessary adjustments. The more freedom we want to give, the more time we have to allow; and the more time we allow, the larger will have to be the quotas or reserves allotted to each member country. The considerable difference in the aggregate quotas of the Agreement and the Keynes Plan is, thus, explained by different conceptions concerning the latitude for national divergencies which would be given to member countries.

In this respect the Agreement is much more conservative than the Keynes Plan. Since the resources of the International Monetary Fund are more limited than those of the Clearing Union (which can create international bank money) the Fund must be more careful and vigilant in its equilibrating policies. Furthermore, with the necessity to procure additional local currency through borrowing from the surplus countries, the latter's influence upon world credit policy would increase irrespective of voting powers.

The Agreement can hardly be subject to the criticism that the member States would be induced to believe that they are going to get something for nothing. The member countries make contributions and are under constant obligation to help to improve the liquidity of the Fund's resources. If there should still be danger that member countries should try to squander their reserves of international money for relief and reconstruction, this danger could best be overcome by an adequate relief and reconstruction policy aside from, and only technically supported by, the international monetary mechanism. Such policies would make it less tantalizing for the member countries to abstain from using reserve funds of international money for long-term investment purposes. For this reason it should be obvious that the International Bank for Reconstruction and Development would substantially help to achieve the aims of the Fund.

THE POSITION OF THE CREDITOR COUNTRIES

That the new plans put the whole responsibility for international payment equilibrium on the creditor countries is not true. But it is correct to say that the plans emphasize the responsibility of the creditor countries as it has never been done before. In this respect we have learned the lesson of the inter-war period. The creditor countries must once for all be shaken out of the "bossy" attitude that the debtor countries can be subjected to the most contradictory policies (as when for instance loans are called back and tariffs are increased simultaneously) simply because they are, as debtor countries, in a weaker bargaining position. The basic obligations of the creditor countries are not invented by Lord Keynes or Dr. White;

they grow out of the logic of a sound and consistent international monetary system.

According to Mrs. Robinson creditor countries have always three possibilities to establish international payment equilibrium: [17]

I. They can try to raise their imports, thus enabling the debtor countries to pay through exports of commodities and services. This can be done in two ways:

(1) The competitive position of the debtor countries can be improved. To achieve this, the creditor countries can (a) lower their protective tariffs; (b) allow their wage rates to rise; and (c) appreciate their currencies.

(2) The creditor countries "can bring about such an increase in employment and expenditure" that consumption of imported goods will increase along with home produce.

II. The creditor countries can lend on long-term, equivalent to their surplus, to countries offering promising investment opportunities.

III. They can accept payment in gold "which involves pressing the rest of the world ever deeper into deflation and slump, or driving it to adopt protectionist devices" until the import surplus of the debtor countries is wiped out.

Mrs. Robinson then points out that the Bancor scheme "in no way obstructs the first two alternatives." It merely changes the character of the third by allowing the creditor countries to amass bancor credit," though the Bancor scheme "by no means encourages a country, still less compels, any country to do so."

Mrs. Robinson's argument explains the meaning of Lord Keynes's insistence that under his plan "a creditor country incurs no burden but is, on the contrary, relieved by being offered the additional option of receiving payment for its exports through the accumulation of a bancor balance" (*Keynes Plan* III-8). Lord Keynes assumes that the necessary adjustments may well be as painful to the creditor country as they are for the debtor country, and that the creditor country will be similarly relieved, consequently, if a breathing space for the correction of maladjustments is allowed.

17. Robinson, *op. cit.*, pp. 165-66.

The Canadian experts argue that the creditor countries are, under the new schemes, just as free to act as they were before. If a country wishes "to reduce its credit balance, it has through participation in the proposed organization lost no single one of the courses of action ever open to it.... It can do the only things it ever could do in these circumstances; it can buy more abroad—goods, services or investments; or it can sell less abroad. It is therefore quite wrong to assume that countries participating in the proposed institution would, because of this participation, be left without control over their international commitments. It may be, and no doubt is, useful to erect danger signals at various stations along the road followed by both debtors and creditors. Such signals are useful reminders. But there is nothing to prevent either creditor or debtor from taking remedial action at any time" (*Canadian Plan*, General Observations, 9).

We must, indeed, not forget that deficit and credit balances (or the amount of "net purchases" from a common pool) are determined by exports and imports (of commodities, services, and securities). The creditor countries' wage, price, credit, employment, and tariff policies are, therefore, constantly influencing the actions of the debtor countries, and it would be wrong to assume that the creditor countries would have to wait passively until the debtor countries have exhausted their quotas.

But even if all this should be admitted—and it can hardly be denied—would it not still be correct to say that the new plans force the creditor countries into the application of policies (concerning such vital matters as credit expansion and wage levels) at times when they are inconvenient or even dangerous? Are the creditor countries not less free in their domestic policies because of the potential purchasing power which the plans put at the disposal of the debtor countries?

These are, indeed, pertinent questions, especially when we assume that the creditor country has achieved the desired state of reasonably full employment.[18] As it approaches full employ-

18. "In the period immediately after the war (and in such subsequent periods in which there should be a tendency in any large or a number of smaller countries, to overemployment) the Keynes scheme enables

ment equilibrium a creditor country has no advantage in increasing its exports or in raising its money income. To be compelled to take such actions, owing to the continued creation of international bank money, would be undesirable for the creditor country. Further expansion would be inflationary, disequilibrating, and therefore dangerous to national and international prosperity.

The Agreement is, in this respect, preferable to the Keynes Plan because it is much less likely to force creditor countries into an overexpansion of credit. It preserves for the creditor countries the right to a domestic credit policy which Lord Keynes is about to destroy in his eagerness to gain this very same privilege for the deficit countries.

If we decide to protect the deficit countries against harmful deflationary policies we should also be willing to protect the surplus countries against harmful overexpansion. This can only be done if, as in the Agreement, the creditor countries are in the position to decide whether or not they will loan additional resources to the Fund. In the Keynes Plan they have to face a creation of international bank money beyond their control and they would, therefore, have to surrender their domestic monetary policy to outside dictation—the very case which is thought unbearable by Lord Keynes when it concerns deficit countries.

---

the export of inflation from one country to another. The inflating country then imposes upon other, fully employed, countries a burden; it competes away supplies and thus diminishes their real income. Admittedly in the long run this problem is not of as great an importance as underemployment. But given the instability of certain national units, it is grave enough to demand an answer."—Balogh, *Political Quarterly*, October-December 1943, p. 351.

IX.

THE DANGER OF OVEREXPANSION

EXPANSIONIST TENDENCY OF THE KEYNES PLAN

NO DOUBT IS POSSIBLE about the expansionist tendency of the Keynes Plan. Section IV-10 states quite frankly: "The plan aims at the substitution of an expansionist, in place of a contractionist, pressure on world trade"; and section X-41 speaks of "the expansionist tendency of the plan, which is a leading recommendation of it as soon as peace-time output is restored and the productive capacity of the world is in running order. . . ."

The gold standard mechanism has, according to Lord Keynes, contractionist tendencies. Its supply of international currency is "determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry" (*Keynes Plan* I-1-c) and even if the gold production chances to be adequate, a chronic shortage of international money could be due to the draining of gold into creditor countries (*Keynes Plan* IV-11),[1] which, as we remember, are under no obligation to expand credit if they do not care to play the game.[2] The burden of adjustment rests, then, with the debtor countries whose contractionist credit policies could easily cause worldwide deflationary pressure (*Keynes Plan* IV-11).

In his brief note on "The objective of international price stability," Lord Keynes explains the expansionist *leitmotif* of his international currency scheme in a most illuminating manner.

1. Lord Keynes, "The Objective of International Price Stability," *Economic Journal,* June-September 1943, p. 186.

2. See above Chapter II, p. 19.

The basic problem is a wage problem. The gold standard confines, according to Lord Keynes, "the natural tendency of wages to rise beyond the limits set by the volume of money, but can only do so by the weapon of deliberately creating unemployment." [3] If wages rise, prices likewise will have to rise since "each national price-level is primarily determined by the relation of the national wage-level to efficiency; or, more generally, by the relation of money-costs to efficiency in terms of the national unit of currency." [4] If prices are prevented from rising, increasing money costs will squeeze marginal producers out of production. Lord Keynes suggests, therefore, that the member States of an international stabilization scheme should be allowed "to pursue, if they choose, different wage policies and, therefore, different price policies." [5] To impose a rigid price level upon a country, as the gold standard did, would mean to submit national wage policies to outside dictation.[6] And since it is not feasible to control money wages by monetary measures, the result of the general tendency of money wages to rise against a stable price level would be unemployment. Consequently it is wiser, according to Lord Keynes, to regard domestic prices as a matter of internal policy and politics,[7] i.e., to leave national price levels free to adjust themselves to unit costs of production.

But while national price levels are left free to adjust themselves to the relation of national wage levels to efficiency, the international currency scheme is, nevertheless, supposed to stabilize foreign exchange rates to a reasonable degree. This seems to be suggested in all plans, since occasional depreciations are, clearly, an extraordinary measure (once the transition period has been passed) which cannot too easily be repeated. But in his brief note in the *Economic Journal* Lord Keynes considers devaluations rather as the normal way of reconciling divergent national price trends though he asserts again "that an international currency scheme can work to perfection within the field of maintaining exchange stability, and

3. *Economic Journal,* June-September 1943, p. 185.
4. *Ibid.*
5. *Ibid.,* p. 186.
6. *Ibid.,* p. 187.
7. *Ibid.*

yet prices may move substantially."[8] Thus the reader of the Keynes Plan is invited to accept exchange stability as one of the aims of the plan and still to consider exchange depreciation (or appreciation) as "the appropriate remedy" for balance of payments disequilibria.[9]

The same attitude is characteristic for the Agreement. The International Monetary Fund has the purpose "to promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation" (I-iii); but the Fund shall approve a requested change in the par value of a member's currency "if it is satisfied that the change is necessary to correct a fundamental disequilibrium. In particular, provided it is so satisfied, it shall not object to a proposed change because of the domestic social and political policies or the member proposing the change" (IV-5-f).

These provisions are very much in line with the Keynesian standpoint and more favorably inclined to depreciation as an equilibrating measure than the corresponding provisions of the White Plan where exchange depreciation is permitted only with the approval of three-fourths of the member votes (as against a simple majority of the votes in the Agreement) and where we do not find the clause that the Fund could not reject a requested change because of domestic policies of the applying country. This provision is the most Keynesian in the whole Agreement and, therefore, of the greatest importance for its interpretation.

The maintenance of exchange stability excludes, of course, a policy of "free" exchanges. All currencies are, at all times, defined in terms of gold and therefore stable in their foreign exchange value. After depreciation or appreciation they are again stable by definition, and as long as they are stable international equilibrium must be maintained by the "mechanism" of the proposed schemes.

Disregarding at present exchange depreciation or exchange appreciation, we have to ask ourselves how this mechanism will work under the strain of divergent national wage and price developments. Of course, "if wages and prices double everywhere alike, international exchange equilibrium is undis-

8. *Ibid.*, p. 186. 9. *Ibid.*

turbed."[10] In other words, if all countries follow equally expansionist tendencies, grave disequilibria are not to be expected as far as the exchange rates in themselves are concerned. But what happens if the national price levels move away from each other?

If Lord Keynes takes the rather fatalistic attitude that wages have a "natural" tendency to rise beyond the limits set by the volume of money, he is forced to ask for a commensurate rise in prices, unless unemployment is to be caused for purely monetary reasons. Thus the gold mechanism is refuted by Lord Keynes because it did not adjust prices to wages but rather (and unsuccessfully) wages to prices.

But if we want to adjust the price-level to the natural tendency of wages to increase and if, at the same time, exchange rates are to remain reasonably stable, we are forced into the following conclusions:

(1) In the *short-run,* adjustments can be avoided only if sufficient reserves of international money are at the disposal of the country which, relatively, overexpands. We know already how strongly this point is emphasized in the Keynes Plan and how large the quotas are set in order to "allow time and method for necessary adjustments" (*Keynes Plan* IV-16).

(2) In the *long-run,* the adjustment must come from equally expansionist wage and price policies in the other member countries. World credit expansion would have to follow the leadership of the most expansionist country, especially if that country happens to be a deficit country, just as, under the gold standard mechanism, world credit contraction followed the most contractionist country especially if that country happened to be a creditor country.

This world-wide expansionist tendency is the only possible conclusion unless we relax our extreme assumptions by

(1) permitting the most expansionist countries to depreciate;
(2) urging the least expansionist countries to appreciate;
(3) forcing the expansionist (deficit) countries into credit contraction and low wage policies.

The problem of exchange depreciation will be discussed in

10. *Ibid.*

the following chapter. Here it suffices to remember that the new plans want to use exchange depreciation sparingly and under control of an international institution; and that exchange appreciation is of all the proposals made in the new plans probably the most unrealistic and impracticable. There remain, consequently aside from exchange control, only credit expansion and credit contraction as alternatives.

If an international currency mechanism is to be built symmetrically, both expansion *and* contraction would have to be used simultaneously, the expansion by the surplus countries and the contraction by the deficit countries. It is, however, dubious whether the new plans are meant to work symmetrically.

We cannot say, of course, that the mechanism of the new plans would exclusively affect creditor countries. But while, in the Keynes Plan for instance, the provisions concerning surplus countries are "spelled out," the appropriate domestic measures of the deficit countries are left rather vague. When the surplus countries have to restore equilibrium conditions, they are supposed to expand domestic credit and domestic expenditures and to encourage an "increase in money rates of earnings" (Keynes Plan II-6-9). No corresponding remark is to be found concerning a contraction of credit and expenditure or a lowering in the money rates of earnings in the deficit countries. This makes the Keynes Plan somewhat lopsided.

The Agreement is noncommittal in its suggestions for deficit and surplus countries. In case that they depart from equilibrium, both will get reports which will contain recommendations. What these recommendations would be is hardly hinted at. We may expect, however, that the emphasis will be on depreciation (and perhaps exchange control) in the deficit countries and on credit expansion and foreign investment in the surplus countries.

This tactful treatment of the problem of appropriate measures to be taken by countries which depart from equilibrium may be politically advisable and all that can be expected from a statement of general principles which the experts of more than forty nations are willing to support. But it does not solve the questions concerning the general policies of world credit control, the measures designed to implement such policies, and the

applications of these measures, decided upon by the Fund or the Union, to the domestic policies of the member countries.

Professor Williams said already in his first article on the new plans that he was not overly convinced "that the board's powers of control have very strong or sharp teeth."[11] The situation has hardly been improved, *in this respect,* by the very Keynesian provision of the Agreement that the International Monetary Fund cannot reject a requested change in the par value of a member currency "because of the domestic social and political policies of the member proposing the change" (IV-5). If we interpret it correctly, this provision seems to imply that the Fund has no power to influence these policies at any time.

This does not mean to say, however, that the Fund could not suggest or even strongly recommend certain domestic policies or that the countries could not be expected to cooperate voluntarily and to support rather than to obstruct the Fund's effort "to develop and to define the functions of the new international bodies and to do this in an ever-flexible fashion as required by the changeability of monetary and international conditions."[12]

The surveys in Chapters VI and VII have already shown that we cannot avoid these problems by reading the gold mechanism into the plans. Lord Keynes is very definitely set against letting debit balances or net purchases have a contractionist effect upon the economies of member countries.

But if we eliminate any trace of contractionist policies from the international scheme and if we want to maintain, at the same time, a semblance of exchange stability, we are left with a one-sided policy of world-wide expansion which would, as we shall try to prove, not always be compatible with national and international stabilization.

Thus we seem to be checkmated by the Keynes Plan's seemingly inherent inconsistency. Indeed, if we combine Lord Keynes's fatalistic attitude concerning the natural tendency of wages to rise with the expansionist tendency of his plan and if we recall the assertion that "the plan should not wander from the international *terrain*" (*Keynes Plan,* Preface), we could,

11. *Foreign Affairs,* July 1943, p. 655.
12. See Nussbaum, *op. cit.,* p. 256.

momentarily, be tempted to refute the Keynesian scheme as inconsistent with national and international stability. But such an attitude would be unfair. It would stress some unfortunate overstatements and omissions and, at the same time, forget to emphasize the fact that numerous provisions of the Keynes Plan imply clearly that the domestic credit policies of the member countries have to be integral parts of an international credit policy whose pursuit, however tentative and groping, would be the most ambitious aim of the Clearing Union (in cooperation, of course, with other international institutions).

LEADERSHIP IN WORLD CREDIT CONTROL

Many of the provisions of the new plans would make no sense at all if we did not take it for granted that the Governing Board of the International Reserve Bank was following a deliberate and comprehensive policy to integrate the credit policies of the member States. Since the Keynes Plan is the most articulate of the drafts as far as the aims of the new schemes are concerned, we select from it some passages which will prove our point.

If the Keynes Plan wants the quantum of international currency governed by the actual requirements of world trade, the Clearing Union must be able and wise enough to expand and contract the supply of international money accordingly. If the Union wants to correct an "excess of world purchasing power," it must quite obviously have some way of telling what a "normal" supply would constitute. If the scheme sets up a mechanism which forces countries back in line, when they depart too much or for too long a time from equilibrium "in either direction," the Governing Board of the Union must be conscious of an equilibrium position which is to be maintained. If it is the Clearing Union's task "to see to it that its members keep the rules and that the advances made to each of them are prudent and advisable," a world-wide scope of the Union's credit policy is clearly implied. "Unduly expansionist conditions in world economy" could not be noticed as such, were the Governing Board not presumed to be able to define what normal expansion would be. Member States could hardly be asked to

take appropriate measures without some indication of which measures are and which are not appropriate. And if it is said to "be desirable that the member States shall consult with the Governing Board on important matters of policy" and if the Board is entitled "to any relevant statistical and other information"—the implication is that an integration of national economic and credit policies is attempted.

Considering these provisions and their implications we cannot be surprised when we are finally told that "the Clearing Union might become the instrument and the support of international policies in addition to those which it is its primary purpose to promote" and that the Clearing Union "might become the pivot of the future economic government of the world" (*Keynes Plan* IX-39).

All this is, of course, not quite consistent with Lord Keynes's wishes for unrestricted domestic policies of the member States. While deflationist policies may be used most sparingly, it is quite obviously imperative that the Governing Board of the Clearing Union should have the power to prevent expansionist policies which would upset international equilibrium. We shall have to sacrifice, therefore, either exchange stability or complete freedom of national wage policies. But at this price we can, indeed, greatly modify the deflationary pressure which was the main shortcoming of the old gold standard mechanism. In an integrated world-wide system of credit control, contraction and deflation could be replaced by a restraining influence upon credit expansion; and in more dangerous cases of international disequilibrium, exchange depreciation could be substituted for deflation.

But all this cannot dispel the fear that the Keynesian scheme could cause a dangerous, world-wide overexpansion of credit.

These inflationary possibilities would be greatly reduced in the International Monetary Fund whose aggregate quotas are much smaller. Creditor countries would not have to fear that they would be forced into overexpansion since the Fund would have to borrow additional resources instead of being able to create them. But inflationary dangers would not be entirely absent. The scheme would have to be elastic and could not

be expected to avoid the dangers of deflation and contraction without being open to possible mismanagement in the other direction. No international currency stabilization plan could possibly be foolproof.

The Keynesian ideas, which have been worked into the Agreement, can be interpreted as follows: Deflationary policies should, as far as possible, be avoided, if necessary even at the price of exchange depreciation. To avoid deflation without paying the price of depreciation would require credit expansion in the "rest of the world." Exchange depreciation is, therefore, apart from being an anti-deflationist device, also an anti-inflationist policy in so far as it protects other countries against the obligation to follow the expansionist policies of individual members. But since exchange depreciation is supposed to be a rarely used extraordinary measure of adjustment it is to be expected that the member countries should try not to overexpand and to avoid, as far as possible, inflationary policies.[13]

ANTI-INFLATIONARY PROVISIONS

It is interesting to note that even Lord Keynes admits the possibility of overexpansion and inflation and that his plan contains several emergency brakes to halt, if necessary, an inflation of international money.

(1) The quantity of international money is capable of deliberate contraction to offset inflationary tendencies in world demand (*Keynes Plan* I-1-c). "The Governing Board shall be entitled to reduce the quotas of members, all in the same speci-

13. This interpretation is similar to the one given by Lord Keynes himself before the House of Lords on May 23, 1944. "We are determined," he pointed out, "that, in the future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of international capital movements or flights of hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instruments of bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors."

fied proportion, if it seems necessary to correct in this manner an excess of world purchasing power" (*Keynes Plan* II-6-13).

(2) The charge of one per cent (or two per cent) on bancor balances "whether credit or debit" in excess of a quarter (in excess of a half) of a country's quota may be remitted on credit balances and increased on debit balances if, in the opinion of the Governing Board, "unduly expansionist conditions are impending in the world economy" (*Keynes Plan* II-6-7).

(3) Since a member State is entitled "to obtain a credit in terms of bancor by paying actual gold to the credit of its clearing account" (*Keynes Plan* VI-27), the power to vary the value of bancor in terms of gold "might have to be exercised if the stocks of gold tendered to the Union were to be excessive" (*Keynes Plan* VI-31). In other words, a decreased price of gold in terms of bancor would decrease gold production and reduce the supply of international currency.

(4) The Keynes Plan contains a warning that "the expansionist tendency of the plan . . . might be a danger in the early days of a sellers' market and an excess of demand over supply" (X-41) and that the proposed overdraft should be replaced by specific aid during a "relief" period of (say) two years (X-42).

Of these anti-inflationist brakes the fourth is by far the most important—but it is only meant as a temporary substitute for the regular plan and not as a part of the regular plan.

To lower the price of gold in terms of bancor would cause a reduction in gold production. This brake is necessary since the countries are allowed to acquire bancor balances with gold—a provision obviously dictated by political reasons and rather inconsistent with the general idea of the plan.

The increasing charges on debit balances belong to a provision which the Keynes Plan itself calls "not essential," and are a rather weak instrument because credit at more than one or two per cent could still be rather cheap.

The reduction of quotas would, if really used, easily upset the whole machine. To reduce the quotas of member States, all in the same proportion, according to Professor Lutz,[14] would

14. See Friedrich A. Lutz, *International Monetary Mechanisms. The Keynes and White Proposals* (Princeton, 1943), p. 9.

be a dangerous weapon. In spite of the provision that no country should have to cut down its actual debit balance, this policy would mean that those countries which have used the greatest proportion of their overdraft facilities would be forced rather too suddenly into deflationist policies—a proposal strangely inconsistent with the *horror deflationis* which characterizes the rest of the Keynes Plan.

The Agreement, according to which credit expansion cannot be forced upon the surplus countries (since the International Monetary Fund cannot create credit), does not need equally strong anti-inflationist brakes. But it does provide for "uniform proportionate changes in the par values of the currencies of all members" (IV-7) and for a revision of quotas (III-2), the only changes, incidentally, which require a qualified majority. These provisions could be used as a possible protection against over-expansion.

MACMILLAN REPORT VERSUS KEYNES PLAN

Even those who are in sympathy with the expansionist tendency of the Keynes Plan must admit that there is a limit to expansion, that expansion which goes too far (or is too fast) may be as dangerous as contraction (and will, as a matter of fact, lead into it) and that the answer to the question whether we should have expansion or not cannot be given in Lord Keynes's summary way but depends very much on the given circumstances. "Expansion" as such lacks precision as a prescription for economic policy. Of course, we prefer expansion to contraction just as we prefer high wages to low wages. But this does not prove that higher wages are always preferable to lower wages from a general economic point of view or that expansion, when unchecked, might not lead into difficulties from which the economy cannot be extricated by further expansion. Lord Keynes knows, of course, that there are limits to expansion. But in spite of the anti-inflationary provisions of the Keynes Plan it must be admitted that the Keynesian proposal does not emphasize and implement sufficiently the limits to expansion. This is probably due to the same deflationary experiences of the early thirties out of which Lord Keynes's epochal *"General Theory"*

was born. But should we forget completely that, at least in the United States, the deflationist thirties followed upon the overexpansion of the twenties?

Concerning the problem of "control over the volume and terms of bank credit" the Macmillan Report of 1931 was a better piece of workmanship than is the Keynes Plan of 1943. The Macmillan Report pointed out that it would be easier to control an expansion in its earlier than in its later stages; that overexpansion would lead to contraction; and that, while it would be difficult enough for a Central Bank to determine the limits for credit expansion, it would be even harder to achieve concerted action on an international basis.[15]

Among the proposals of the Macmillan Report[16] we find, therefore, not a one-sided plea for expansion but rather the advice that "alternative excesses of enthusiasm and depression" should be avoided and that "with this end in view the Central Banks should confer at frequent intervals to decide whether the general tendency of their individual policies should be towards a relaxation or a tightening of conditions of credit." The Macmillan Report does *not* ask for the fullest autonomy of each country in order to free "the natural tendency of wages to rise beyond the limits set by the volume of money" from outside dictation.[17] Quite to the contrary: the Macmillan Report requests that "in particular, each Central Bank should remain free to attract gold to itself whenever it *deliberately* desired to do so, without incurring blame or exciting complaint from other Central Banks; . . . and also to raise its own bank rate for the sake of checking inflationary tendencies at home, even if the tendencies abroad were of a contrary character."

It could perhaps be argued that the Macmillan Report is old-fashioned, that it tries to defend the gold mechanism and that it was written before Lord Keynes's *General Theory* was conceived and when Lord Keynes (a member of the Committee on Finance and Industry which published the Macmillan Report)

15. *Committee on Finance and Industry Report,* p. 131. See above Chapter III, p. 29.
16. See above Chapter III, pp. 30-31.
17. Lord Keynes, *Economic Journal,* June-Sept., 1943, p. 178.

"was still moving along traditional lines. . . ."[18] Closer scrutiny of the quotations from the Macmillan Report in Chapter III above will uncover formulations which are no longer tenable. But we can just as well argue that the new Keynesian approach has gone too far when it ignores the warning against over-expansion which is the very core of the Macmillan Report.

THE MEANING OF EXPANSION

The expansionist tendency of the Keynes Plan does not simply concern an expansionist pressure on world trade. It is to be interpreted as a credit expansion on an international scale which helps the individual member States to reach and to maintain (as near as possible) a full employment level as a precondition of healthy international trade.

The Keynesian attitude presupposes that a trend towards a full employment level is not the normal state of affairs in a capitalist economy and that, on the contrary, underemployment may be the rule unless constant expansionist pressure is exerted.

The general ideas of the Keynesian Theory "are extremely simple."[19] The national income of a country is either spent on consumption or it is saved. If the saved portion of the national income is invested (i.e., spent on capital goods or durable consumers' goods) the whole income received has been spent; and since one man's expenditure is other men's income we can expect that the same amount as in the period before will again be received as income. Assuming, however, that part of the saved portion of the national income is not invested, the national income will decrease and unemployment will occur in the capital goods industry. As the national income decreases consumption decreases spreading unemployment all over the economy and even among other countries whose export trade will suffer.

The unwillingness to consume or to invest can make itself felt even more directly in international trade. D. H. Robertson refers to "a recurring tendency in some countries to allow their

18. J. M. Keynes, *The General Theory of Employment, Interest and Money* (London, Macmillan, 1936), p. vi.
19. *Ibid.*, p. viii.

earning power, and therefore their spending power, to outrun ... their spending-*will*—a tendency to fail to make full use, for purposes either of consumption or of investment, of the command over resources abroad which is passing into their lawful control." [20]

The pre-Keynesian theory, though not unacquainted with the dangers of deflation, did not believe that a deflationary spiral could reach very dangerous depths. When investment should really fall short of savings, it was argued, the rates of interest would decrease far enough to induce additional investment. But this argument need not be conclusive. It must not be taken for granted that what is not spent on consumption (and is therefore, by definition saved) will necessarily intensify the pressure on interest rates. Savings which are not instantaneously invested cause the national income to fall and as the national income decreases savings will decrease.

Once we admit that the national income may shrink, that consumption and investment may decline, pulling each other down in a vicious spiral, and that hoarding and credit contraction may destroy what little savings are forthcoming at a low income level, then we have also to admit that the anticipated rate of profit may become very low and even a minus quantity. Then it can happen that the economy remains for a long time at an underemployment level, with the national income far below its potential size.

This is the danger which Lord Keynes has in mind when he wants the economies of the member States put under permanent expansionist pressure and when he is sensitive to everything which may cause or spread contraction.

THE DANGER OF OVEREXPANSION [21]

Let us assume that an expansion process, financed by credit creation, is under way. New money is injected into the economy, the national income increases. Men employed in the production of new capital goods will spend part of their newly earned

20. Robertson, *Economic Journal,* December, 1943, p. 354.

21. With the following, cf. George N. Halm, *Monetary Theory,* Chapters XVIII and XIX.

money on consumption. New consumers' goods will be ordered and the money spent on consumers' goods will become income in the hands of those who participate directly or indirectly in the production and the marketing of these consumers' goods. This is the famous "multiplier effect."

Increasing consumption will induce additional investment. To produce more consumers' goods new machines may be required thus raising the demand for capital goods momentarily way above the normal replacement demand. Furthermore, if the demand for the services of durable consumers' goods increases, more durable consumers' goods have to be produced and production will, therefore, increase many times the amount spent per period of time for these services. This effect is known as the principle of acceleration of derived demand.

Multiplier and acceleration principle suffice to show how the upswing, once started, propels itself from revival into prosperity while credit expansion is constantly at work financing the absorption into the productive process of the unemployed factors of production.

Everything goes well as long as sufficient unemployed resources are available. The process of expansion is not inflationary in the ordinary meaning of the word as long as an increasing social product matches the expanding purchasing power. The average level of prices may remain approximately stable.

But as the expansion continues, as more and more unemployed resources are absorbed and as further resources are needed for the continuation and completion of the production processes which have already been embarked upon, the means of production, no longer easily obtainable, must be hired away from other industries. Then prices will begin to rise quite generally, and the expansion of credit threatens to become inflationary in the ordinary sense of the word.

This does not mean that credit expansion could not technically be continued, especially if, in line with the philosophy of the Keynes Plan, the member States would follow a parallel policy of expansion. Even foreign exchange rates could, then, be kept stable. But this is not the decisive point as we shall presently see.

Once a full employment situation is reached or approached the process of expansion must sooner or later come to an end and will be followed by a process of contraction. This is due to the following circumstances:

(1) At full employment consumers' goods production can only be increased at the expense of capital goods production—and vice versa.

(2) The monetary authority will be reluctant to permit further credit expansion for fear of outright price inflation.

(3) This sudden drying up of one of the main sources of the supply of loanable funds will raise the rates of interest.

(4) It becomes necessary to finance further investment exclusively through savings and this, at a given income level, means decreasing consumption.

(5) Investment, however, can only be maintained at a high level when the rate of growth of consumption is maintained.

(6) But since full employment is reached, consumption can only be increased at the expense of the production of capital goods. Again, if employment in the capital goods industry is decreased it becomes impossible to maintain even the present level of consumption.

(7) Profits will decrease owing to the increased production of durable goods (whose prices decrease) and to the increased competition for factors of production (whose prices increase).

Thus we see that a typical expansion process will lead to an overdevelopment of the capital goods industry; and since both producers' and consumers' goods industries are geared to a mutual rate of growth, which it is impossible to maintain, a contraction process must follow.

There is no perfect cure for this disease. Further credit expansion could make things only worse since it would lead the economy into outright inflation without being able to overcome the basic difficulty—the hypertrophy of the capital goods industry.

Once the contraction process has begun the driving forces of the expansion process work in reverse. Decreasing investment means unemployment and a decline in consumers' purchasing power. Loanable funds, rather than being invested and spent

for wages, are paid back to the banks, which, in turn, fail to lend them out again, partly because of an increased liquidity preference of their own and partly because of lacking demand for loanable funds. The impact of this decrease in effective demand leads to a general fall in prices.

Later on it may be possible to stem the deflationary tide by the injection of new purchasing power into the economy in order to prevent the contraction from going further than required by the disproportionalities which developed during the expansion period.

CONCLUSION

This short recapitulation of modern business cycle theory will serve to show that expansion as such cannot claim to be an economic policy which can be applied with equal success under all circumstances. Even when used in times of underemployment it remains a treatment which, while indispensable, needs most careful supervision while it is applied.

Of course we cannot expect to find a solution of this most difficult problem of credit control in a plan which is mainly devoted to international currency stabilization. But we could expect to find either a neutral instrument for international monetary policy or else an elaborate plan for an integrated world credit control. That the Keynes Plan is neither is its greatest shortcoming. Its neutrality as an instrument is impaired by Lord Keynes's prejudice against deflation and contraction; and its provisions for an integrated credit control are too vague and too one-sidedly expansionist to serve as a reliable guide for post-war credit policy.

In fairness to Lord Keynes it should be said, however, that the proposals for an International Clearing Union constitute only one of "four main lines of approach" which "taken together . . . may help the world to control the ebb and flow of the tides of economic activity" (*Keynes Plan,* Preface).[22]

22. The four main lines of approach suggested by the Keynes Plan (Preface) are: "1. The mechanism of currency and exchange. 2. The framework of a commercial policy regulating conditions for exchange of goods, tariffs, preferences, subsidies, import regulations and the like. 3. Orderly conduct of production, distribution, and price of primary

Nevertheless, it can hardly be denied that, if mismanaged, the Plan contains enough dynamite to endanger gravely the post-war world which it sets out to save from contraction. Lord Keynes admits this danger and even proposes to replace the overdraft facilities of the Clearing Union by "specific aid" during a relief period of, say, two years. But this, of course, would not avoid the danger of another 1929.

Under the Keynes Plan it may be difficult, especially for the creditor countries, to avoid overexpansion and the depression which necessarily follows. The expansion would probably last through the reconstruction period. For the United States this would mean, in addition to domestic expansion, export surpluses, increasing credit balances with the Clearing Union, and, according to the idea of the Keynes Plan, further monetary expansion. The degree and speed of the expansion process would not be determined by domestic considerations alone but also by the obligations of the United States as a creditor country. There is a strong probability that this expansion would go too far. And the contraction which would necessarily follow would become even more serious owing to the fact that the surplus countries would at the same time be required to develop import surpluses.

---

products so as to protect both producers and consumers from the loss and risk for which extravagant fluctuations of market conditions have been responsible in recent times. 4. Investment aid, both medium and long term, for countries whose economic development needs assistance from outside.")

X.

EXCHANGE RATES AND EXCHANGE CONTROL

"MANAGED FLEXIBILITY"

PLANS FOR INTERNATIONAL CURRENCY stabilization seem *a priori* committed to the maintenance of stable exchange rates. The International Monetary Fund of the Agreement has, indeed, the purpose "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation" (I-iii).

The Keynes Plan aims at "an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations are prevented" (I-1-b), and does not permit (except under special conditions) subsequent alterations without the permission of the Clearing Union. On the other hand, the Union may even *require* "a stated reduction in the value of the member's currency, if it deems that to be the suitable remedy" (II-6-8-b). Generally speaking the Keynes Plan takes the attitude that if a country's "wage and price levels in terms of money are out of line with those elsewhere, a change in the rate of its foreign exchange is inevitable" (IV-18).

Considering these provisions we can interpret the Keynes Plan as based on flexible rather than fixed exchange rates,[1]

1. Not according to Mr. Benson (*Parliamentary Debates, cit. supra*, pp. 59-63) who complains that the new plans do not propose relatively stable exchanges nor reasonably stable exchanges but fixed exchanges which shall only be altered by permission. Mr. Benson mentions three prerequisites to the possibility of fixed exchanges: (1) an unvarying ratio between international price levels, (2) an equation of

though the flexibility is a managed flexibility and is under no condition to be permitted to degenerate into unilateral action and competitive exchange depreciation.

The Agreement, though committed to the promotion of exchange stability (I-iii), has practically accepted the Keynesian viewpoint concerning exchange flexibility which the other plans had never seriously contested. Changes in the par values of member currencies are possible but they shall not be made without the approval of the Fund nor shall the Fund have the right to change the par value of a member's currency without the country's approval. The members agree not even to propose a change in the par value of their currencies "except to correct a fundamental disequilibrium" (IV-5-a).

These provisions have to be interpreted as an attempt not only to eliminate single-handed action by member countries or by the Fund, but also to brand exchange depreciation as an extraordinary and, consequently, rare measure: the exception from the rule.

Article IV-5-f of the Agreement which, because of its great importance was already referred to in Chapters VII and IX, says that "the Fund shall concur in a proposed change . . . if it is satisfied that the change is necessary to correct a fundamental disequilibrium" and that the Fund cannot reject a requested change "because of the domestic social and political policies of the member proposing the change." Furthermore, "in its relations with members, the Fund shall recognize that the postwar transitional period will be one of change and adjustment and in making decisions on requests occasioned thereby which are presented by any member it shall give the member the benefit of any reasonable doubt" (XIV-5).

---

imports and exports on current account, and (3) capital movements which represent and equate material movements. He believes that a system of frequent adjustments through orderly depreciation will be exposed to disturbing speculative movements since nobody will buy the goods of a country for which a depreciation is impending until the depreciation has taken place. Mr. Benson is partly right. But he does not show how his system of free exchanges could be made secure against competitive exchange depreciation. For further critical points see below, p. 126.

But not all changes in the par values of member currencies require the special permission of the Fund. The Agreement provides that, after consulting the Fund, a member may change the established parity of its currency, provided the proposed change, inclusive of any previous change since the establishment of the Fund, does not exceed 10 per cent. In the case of application for a further change, not covered by the above and not exceeding 10 per cent, the Fund shall give its decision within seventy-two hours if the member so requests (*Agreement* IV-5; *Joint Statement* IV-4).

Like the White Plan, the Agreement permits fluctuations of exchange rates within an agreed percentage of parity (IV-2). Lord Keynes suggested a similar artificial gold point policy in his *Treatise on Money* where he proposed to increase the spread between the gold points under the gold standard by enlarging the difference between the official buying and selling price of gold. "It is this distance," he wrote, "which protects the money market of one country from being upset by every puff of wind which blows in the money markets of other countries."[2] Of course, the permissible fluctuations would have to stay within a rather narrow range, so that international short- and long-term lending would not suffer from undue risk. The provision has the advantage of making it more expensive for member countries to use the resources of the Fund. The member countries would, therefore, have an inducement to use their own reserves of gold and foreign currency before they would buy from the Fund. The permitted fluctuations of parities, furthermore, would have the modestly equilibrating effect of making the currencies of deficit countries slightly cheaper and those of the surplus countries slightly more expensive.

Thus we see that both the Agreement and the Keynes Plan propose a mixed system of stability and flexibility. Since both exclude categorically unilateral action, condemn sharply competitive exchange depreciation, and make, consequently, exchange depreciation normally dependent on the permission by the Fund or the Union, we can say that both subscribe to the

2. J. M. Keynes, *Treatise on Money* (New York, Harcourt, Brace and Co., 1930), II, 325.

principle of managed flexibility in the adjustment of the exchange values of the member currencies.

The advantages of such a mixed system are fairly obvious. Only a system of managed flexibility could (1) give enough freedom for domestic policies without requiring dangerously large reserves of international money; (2) avoid deflationist tendencies without having to substitute world-wide credit expansion; (3) allow for depreciation without having to fear competitive exchange depreciation; and (4) master the adjustment period after the war without too many exchange restrictions.

But the whole scheme would, nevertheless, remain an attempt to achieve and to maintain the maximum of exchange stability that can prudently be hoped for in the post-war world. Exchange stability would be the rule, depreciation the exemption and no major depreciation would be possible without a majority of member votes.

Professor Graham criticizes this attitude with the argument that the new plans "would set up a (wobbly) system of fixed rates (maintained until collapse is imminent) without any provision for the adoption of the internationally unified price level policy under which, alone, fixed exchange rates can make sense."[3] There is a grain of truth in this argument. A compromise between rigidity and flexibility can, of course, easily be interpreted as an inconsistent policy, "a recipe how to go swimming without getting wet," as another economist recently remarked. But the experts who drafted the Agreement do not want to combine stable exchanges with diverging price developments. They propose rather that we should try to do our best in integrating the domestic monetary policies of the member countries and that we should change the parities only when national employment policies lead to divergent price developments; furthermore, that these changes should not be made by unilateral action.

Professor Viner believes that the difficulties of substituting group management for unilateral action would be rather

3. See F. D. Graham, *Fundamentals of International Monetary Policy* (Princeton, 1943), p. 10.

formidable since "majority consent to the depreciation of a major currency would scarcely ever be obtainable from an international body."[4] Of course, if a local association of grocers would meet to act upon the application of one member to be permitted to cut his prices to the other members' disadvantage, this right would most certainly not be granted. Similarly, the Fund would never permit *competitive* exchange depreciation. On the contrary, it would be the Fund's function to *prevent* competitive depreciation. Only if the general wage and price structure of a country indicate an overvaluation of its currency will the right to depreciate be granted. Provision IV-5-f of the Agreement does, of course, not forbid a careful study by the Fund of the domestic economic situation of the applying country. It only means to say that the Fund cannot reject a requested change because it disapproves of the member's policies. However, should the requested change constitute an undervaluation of the country's currency in terms of its domestic wage and price levels, the Fund would have the power and the duty to refuse to grant the request.

Again we seem to find ourselves in an impasse. Competitive exchange depreciation cannot be permitted. "Free" fluctuations of exchange rates are liable to degenerate into competitive exchange depreciation and are, consequently, excluded, just as, on the other hand, exchange control is to be avoided if possible. But managed flexibility of exchange rates presupposes action of an international body whose members may be expected to guard jealously their own competitive advantages and to be, therefore, rather reluctant to grant to any member State the right to depreciate. And rigid exchange rates could only be maintained if the national wage and price policies of the member States were sufficiently integrated to reduce divergent price trends to minor proportions.

A compromise solution which may lead us out of this impasse is a complicated and delicate affair which will require an unusual amount of self-discipline and foresight on the part of the member countries. But a compromise is inescapable if we are to avoid the rigid system of the old gold standard, the innumerable

4. Viner, *op. cit.*, p. 94.

restrictions of exchange control, the turmoil of free exchanges and the danger of competitive exchange depreciation.

Such a compromise solution would have to achieve: (1) the elimination of frequent and violent fluctuations of exchange rates—as incompatible with a "balanced growth of international trade"; (2) the establishment of exchange rates which are correct and, therefore, "neutral" in terms of artificial export advantages or disadvantages; (3) the substitution of managed flexibility for outright rigidity whenever exchange stability would have to be bought at the price of a dangerous deflation and depression; and, finally (4) the integration of the domestic credit policies of the member States which cannot possibly be left entirely free if order is to be achieved in the exchange ratios of the currencies of the member States.

PURCHASING POWER PARITY

It would be comparatively easy to solve our problem if we knew how to compute correct exchange values under given conditions. Then we could keep exchange rates at least "neutral," could adjust them more easily to divergent trends in national price levels and could design an objective method of determining exchange values which would greatly reduce the political difficulties surrounding an orderly exchange depreciation by action of an international body. Unfortunately no method has, as yet, been found to detect promptly over- or undervaluations of national currencies. A theoretical answer to this difficult question depends on too many factors to be practically helpful. But a brief recapitulation of the purchasing power parity theory will at least clarify the problems which confront us when we try to determine correct exchange rates.

The naïve purchasing power parity doctrine says that changes in the foreign exchange values of national currencies are determined by, and are in proportion to, the changes in the domestic purchasing powers of these currencies. The famous Bullion Report stated as early as 1810 that "in the event of the prices of commodities being raised in one country by an augmentation of its circulating medium, while no similar augmentation in the circulating medium of the neighbouring

country has led to a similar rise in prices, the currencies of the two countries will no longer continue to bear the same relative value to each other as before. The exchange will be computed between these two countries to the disadvantage of the former."

After a period of violent inflationary price changes, the purchasing power parity theory may serve as a useful reminder that pre-inflation parities are of historical interest only and that the new exchange rates are to be found in the neighborhood of the new purchasing power parities. Had this simple truth been clearly understood in the middle 1920's much unnecessary suffering from deflation could have been avoided.

But only the approximate and not the exact location of exchange values can be ascertained by a comparison of the fluctuations of national price levels. The general price level of a country (as an expression of the purchasing power of its monetary unit) includes all sorts of prices irrespective whether the commodities to which these prices belong are traded internationally or within national boundaries only. Only internationally traded goods, goods which are imported and exported, will influence the demand for and the supply of foreign currency and, consequently, the rate of exchange. Commodities which are only domestically traded, on the other hand, have no direct bearing on the exchange value of the currency and their prices may, therefore, fluctuate without affecting directly and immediately the rate of exchange.

Should we, then, choose an index of prices of internationally traded goods to determine the new parities? The answer must be "no," for two reasons:

(1) We do not know which goods will actually enter into international trade. When the exchange value of a currency falls, more goods will be exported (and less will be imported) since the country's products become automatically cheaper for foreign buyers (and foreign products more expensive for the domestic buyers). Obviously we cannot ascertain the rate of exchange by an average price level of goods whose variety and number depend on the very rate of exchange which they are supposed to determine.

(2) In case of internationally traded commodities the pur-

chasing power parity theory becomes an empty truism[5] because it is obvious that the national prices of internationally traded goods (adjusted to account for transportation costs, tariffs and other delivery expenses) tend to equality as between different markets when translated into each other by the rates of exchange. A process of equalization through arbitrage takes place so automatically that the national prices of these commodities seem to follow rather than to determine the movements of the exchange rates.

But to choose the prices of domestically traded goods would even be less satisfactory, since, as we have already seen, there is no direct relation between their changes and the fluctuations of foreign exchange rates. We have also no reason to assume that the prices of domestic and of internationally traded goods will always change in the same degree or even in the same direction. It is therefore wrong to expect the fluctuations of exchange values and of internal purchasing powers to be exactly or even nearly proportional. Of course, where international trade is an important part of the total trade of a country there must be a strong interdependence of both movements.

MODIFICATIONS OF THE PURCHASING POWER PARITY THEORY

The rate of exchange between the monetary units of paper standard countries is affected by an increase (or decrease) of one country's demand for the other country's products even though the price levels may remain the same—an important fact for which the naïve purchasing power parity theory has no explanation. Under the gold standard mechanism, where the exchange rates are kept relatively stable, the price levels would have to change.

Import duties or subsidies would cause another deviation from the results of the naïve purchasing power parity doctrine. If under the gold standard system new or higher duties would be levied by a country, the exporting country would have to lower its prices to be able to sell on the protected market. In

5. See the excellent treatment of the purchasing parity doctrine in Barrett Whale, *International Trade* (London, Thornton Butterworth, Ltd., 1934), Chapter III.

case of paper currencies the same effect could be achieved by a lowering of the foreign exchange value of the exporting country's money, while commodity prices could, in this case, remain the same as before. Changes in transportation cost would have similar effects.

Last but not least, we have to mention one-sided payments (capital movements, interest payments, reparations) as a powerful deterrent to the usefulness of the purchasing power parity theory. Again there are two ways by which the necessary export-import adjustment can be achieved. If country A borrows from country B, country A acquires B's currency to buy in B or elsewhere. The increased supply of B-currency on A's exchange market will lower the exchange value of B-money in terms of A-money and it will, consequently, become cheaper for country A to buy in country B. At stable exchange rates under the gold standard the same result could have been achieved by a contraction of the purchasing power and a fall of prices in country B. It can easily be seen that the adjustments are in both cases at variance with the purchasing power parity rate of exchange.

PRACTICAL DIFFICULTIES

Our theoretical analysis shows how extremely difficult it will be to determine even approximately correct exchange values in the post-war period. We have only to enumerate the different factors which are certain to influence foreign exchange values, and to consider for a moment how hard it will be to determine the relative strength of these factors in the different member countries during the post-war period, to understand the complexity of the task confronting us.

(1) National price levels, the basis on which even the naïve purchasing power parity theory rests, will not be definitely known after the war before national price controls are abolished. Domestic price controls and exchange controls are interrelated and will have to be relaxed simultaneously.

(2) National price levels should not be discussed as if they were *entirely* free to adjust themselves to money rates of wages and efficiency. Lord Keynes's assumption concerning the "natu-

ral tendency of wages to rise" must be modified unless exchange stabilization is to be victimized completely. Whether the adjustment of prices or of exchange rates is preferable depends, at least partly, on the elasticity of the cost structure of a country and on the relative importance of its foreign trade relations. But if Lord Keynes's attitude is controversial, so is the attitude of those who consider an adjustment of national price levels (to maintain stable parities) as a problem of exclusively monetary significance.

(3) A country asking for a downward adjustment of its rate of exchange cannot escape a close scrutiny of its financial policies in general, including wage, fiscal, and credit policies. Even though the International Monetary Fund cannot refuse a requested change in the par value of a member's currency "if it is essential to the correction of a fundamental disequilibrium," the Fund has to know these policies in order to determine the appropriate rate of exchange. Without investigating into the relationships between prices, wages, and efficiency, we could be tempted into palliating unsound domestic policies by granting the right to "undervaluate."

(4) The relative importance of domestic and internationally traded goods in the different countries of the world has to be considered. The greater the proportion of export to total production of a country, the greater the interest of the country in stable exchange rates since fluctuating rates could easily unbalance its national economy.

(5) The larger the country and the more independent from the rest of the world, the more will it be interested in economic stability rather than in exchange stability—an attitude not necessarily at variance with the interest of other countries whose exports depend largely on the employment levels in the leading countries.

(6) In many fields of economic theory we have come to realize that one of the most important factors determining demand is the size of the national income. International demand too will be greatly influenced by the income and employment level which the countries of the world will manage to maintain. This should be clearly understood by those who are inclined

to believe that employment policies should always be secondary to price and exchange rate stabilization. Should a policy of exchange stabilization be driven to the point where we have to pay the price of substantial underemployment for the maintenance of stable exchange rates, the final outcome could again be exchange control, bilateralism, and a rapidly shrinking international trade volume.

(7) The elasticity of the world's demand for a country's products (and the elasticity of the country's demand for the world's products) are most difficult to predict. But the respective elasticities of demand and supply in international trade are a powerful factor in the determination of the relative exchange values of the countries' currencies, a factor which may push the exchange rates far away from their purchasing power parities. The dollar and the pound sterling will be outstanding examples for two extreme positions in the post-war world. The demand for dollars will be insatiable while the United States will require comparatively little from the rest of the world; and, owing to the "abnormal balances" accumulating in England, Great Britain's demand for foreign exchanges will by far exceed her power to export. But virtually no country in the world will be able to estimate its post-war position in international trade until reasonably normal trade relations have been reestablished by trial and error methods and until those structural changes which will remain as a permanent aftermath of World War II will stand out more clearly.

(8) As to import duties, which also modify the purchasing power theory, we cannot make predictions at a time when not even the question of post-war frontiers has been settled—to mention only one obvious difficulty. No regulation of exchange rates by an international Board can take place without a discussion of the tariff policies of all countries concerned. This may turn out to be a blessing in disguise since it may help to make the different countries see their mutual interdependence.

(9) The inelasticity of a country's supply in international markets may be caused by insufficient reserves of international money. A country without internationally liquid funds would have to make frantic efforts to sell in foreign countries, and this

would impair its market position and, consequently, its currency's exchange value. To make adequate reserves of international money available to countries which will be in need of these reserves after the war is, therefore, an integral part of a policy which tries to stabilize (within limits) the relative exchange values of the world's currencies. It should be obvious that the creation of adequate reserve facilities cannot simply wait until stability has been achieved in every other field.

(10) If one-sided payments, as they are connected with international capital movements, tend to distort the computations of the naïve purchasing power parity theory, the postwar exchanges will not be easy to find. International loans will be made and the concomitant changes in export-import relations will be brought about, at least partly, by adjustments in the exchange values of the respective currencies. More than that: "the difficulties of many debtor countries might be obscured for a period by stabilization credits, but they might build up economies that could continue only on the basis of a constant inflow of credit. When the supply of these credits is exhausted and no long-term loans are available, the inevitable adjustments might prove more painful than if they had been made in the first place."[6] The creditor countries too will face great adjustment problems when the changeover from a "favorable" to an "unfavorable" balance of trade has to be accomplished.

(11) Exchange fluctuations would be reduced by multilateral clearing since, in a system with multilateral clearing, the deficit countries, which have to increase their exports, have virtually the whole world market to sell in while the export possibilities of those countries which are tied by bilateral payment and trade deals have to press their exports into narrow markets. The problem of multilateral clearing and exchange stability are, therefore, closely interrelated.

6. See J. H. Riddle, *British and American Plans for International Currency Stabilization*, National Bureau of Economic Research (New York, December 1943), p. 27.

INITIAL DETERMINATION OF PAR VALUES

Faced with these many difficulties we may be inclined to give up, to declare that we have no way of finding out which exchange rates would be correct and to propose that the problem should be postponed until more nearly normal times have arrived. Such a proposal would, indeed, be preferable to an attempt towards *permanent* stabilization of highly hypothetical exchange rates. But no such permanent stabilization is seriously considered.

The Agreement leaves the initial determination of par values to the members. When the Fund notifies the members that it will shortly be in a position to begin exchange transactions, the members shall communicate within thirty days the par values of their currencies based on the rates of exchange prevailing on the sixtieth day before the entry into force of the Agreement (XX-4-a). If a member or the Fund considers this par value of the member's currency as unsatisfactory, "the Fund and the member shall, within a period determined by the Fund in the light of all relevant circumstances, agree upon a suitable par value for that currency" (XX-4-b). These changes in the par value will not be counted into the 10 per cent change which cannot be objected to by the Fund according to Article IV-5-c.

These provisions cut the Gordian knot by starting from given exchange rates despite the fact that these rates may require very substantial adjustments. Thus prolonged and difficult negotiations between the Fund and the members are avoided and a trial and error method of adjustment is substituted for decisions which could not be made satisfactorily immediately after the war. But it is important to note that the necessary adjustments would take place under the vigilance of the Fund rather than by unilateral action.

EXCHANGE CONTROL

Any plan for international monetary cooperation will have to solve the difficult problem of relaxing the restrictions of foreign exchange control. That these restrictions exist enables us to face the monetary problems of the post-war period with

greater equanimity than was true after the last war. "The task of currency stabilization this time will not be to prevent wild gyrations of exchange rates but to work towards the economic and political conditions and the level of exchange rates under which the controls can be relaxed.[7] This will be a complicated task not only because this level is not easily ascertained, but also because exchange control is such a powerful political instrument that the nations now practicing it will find it hard to dispense with it.

We have already seen that the new plans intend to use exchange control measures even though they are eager to have all the old restrictions (except upon capital transfers) removed. Since the plans are essentially compromise proposals which have to construct a craft which will be seaworthy in the rather stormy waters of the post-war period, we cannot be surprised to find exchange control among the proposed instruments.

Several important provisions of the Agreement deal with exchange control.

Article VIII obliges members not to impose "restrictions on the making of payments and transfers for current international transactions" or to engage in "any discriminatory currency arrangements or multiple currency practices except as authorized under this Agreement or approved by the Fund." This is in line with Article I-iv according to which it is the purpose of the Fund "to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade." [8]

Exchange restrictions are only permitted, as exceptions from the rule, in three cases:

(1) "A member may not make net use of the Fund's resources

7. See Williams, *Foreign Affairs*, January 1944, p. 237.

8. Payments for current transactions are defined in Article XIX of the Agreement as "payments which are not for the purpose of transferring capital" and include "all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities; payments due as interest on loans . . . ; payments of moderate amount for amortization of loans . . . ; moderate remittances for family living expenses."

to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund" (VI-1) "but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments" (VI-3).

Of course, this is more easily said than done. Lord Keynes reminds us that "it is an objection to this that control, if it is to be effective, probably requires the machinery of exchange control for *all* transactions . . ." (*Keynes Plan* VII-33). The Keynes Plan suggests that an attempt should be made to control "short-term speculative movements or flights of currency whether out of debtor countries or from one creditor country to another" (VII-35) *at both ends* (VII-33), i.e., to make the necessary controls a matter of joint rather than unilateral action. Article VIII-2-b of the Agreement states that "members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective . . ."

That short-term speculative movements of capital and so-called capital flight movements should not be supported by an international payment organization is obvious since "there is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds, which constitute an unwanted import of capital, yet cannot safely be used for fixed investment" (*Keynes Plan* VII-32).

(2) Exchange restrictions may become necessary, as we have already seen,[9] when the Fund has to declare a currency formally as "scarce" (*Agreement* VII-3). The Fund will, then, "apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation and any other pertinent considerations" (VII-3). Furthermore, a decision by the Fund to apportion a scarce currency "shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose

9. See above Chapter VI, pp. 70-72.

limitations on the freedom of exchange operations in the scarce currency," and "the member shall have complete jurisdiction in determining the nature of such limitations, but they shall not be more restrictive than is necessary to limit the demand for the scarce currency to the supply . . .; and they shall be relaxed and removed as rapidly as conditions permit" (VII-3).

We recall that these provisions, which seem to be rather inconsistent with the general objectives of the Fund are, nevertheless, indispensable, at least in theory, if we do not want to force the prospective surplus countries to lend to the Fund their local currency up to the aggregate of quotas of the deficit countries.

But while these provisions concerning the rationing of scarce currencies are indispensable, it may be doubted whether they are, in their present form, not too sweeping. That the Fund's resources of a member currency are scarce does not necessarily mean that "any" country's supply of that currency is scarce and it may, therefore, be quite unnecessary, and inconsistent with the purposes of the Fund, to give to each and every member the right to impose limitations on exchange operations in the scarce currency. The members may even make it a practice to draw on the Fund first and to be more careful with their own reserves. These reserves may partly consist of the scarce currency or of currencies of countries in which the scarce currency is not yet scarce. In such cases there would be no need for the introduction of exchange control.

(3) During the transition period "members may . . . maintain and adapt to changing circumstances . . . restrictions on payments and transfers for current international transactions," but "as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability. In particular, members shall withdraw restrictions maintained or imposed under this Section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund" (XIV-2). "Not later than three years after the date on which the Fund begins operations and

in each year thereafter, the Fund shall report on the restrictions still in force. . . . Five years after the date on which the Fund begins operations, and in each year thereafter, any member still retaining any restrictions inconsistent with Article VIII . . . shall consult the Fund as to their further retention" and in exceptional circumstances the Fund may "make representations to any member that conditions are favorable for the withdrawal of any particular restriction . . ." (XIV-4).[10]

Since the Agreement is intended to cover the transition period, it cannot avoid a certain amount of exchange control. This may be a reason for postponing the creation of an international monetary organization, a problem to which we shall return in Chapter XII. But if we postpone our permanent arrangements we shall need for the particularly dangerous post-war years a "transition program" which will have to include provisions for the relaxation of exchange restrictions.

PRO AND CON EXCHANGE CONTROL

A case for the maintenance of exchange control measures can be made on the following grounds:

(1) The interrelation of domestic price and of exchange controls, together with the advisability of maintaining price controls during the transition period from war to peace, implies the maintenance of exchange restrictions for at least the same period.

(2) The very act of relaxing exchange restrictions is a delicate process for which many countries will require such outside help as the Fund is designed to render. It is, therefore, quite understandable that the operations of the Fund and the old exchange restrictions will temporarily overlap.

10. Lord Keynes considers it as a major advantage for England that she is under the Joint Statement entitled "to retain any of those wartime restrictions, and special arrangements with the Sterling Area and others . . . without being open to the charge of acting contrary to any general engagements" into which she has entered (House of Lords, May 23, 1944). Louis Rasminsky on the other hand, considers this escape clause "the least satisfactory feature of the Joint Statement, particularly for a country like Canada" whose peculiar structure makes it especially interested in the earliest possible restoration of multilateral clearing.—*Foreign Affairs,* July 1944, p. 602.

(3) The first tentative exchange values cannot be expected to be correct. Some currencies will be overvalued, others will be undervalued. Overvaluation would lead to corrective depreciation. But the anticipation of a depreciation "would create a speculators' paradise or would involve rigid and comprehensive exchange control." [11]

(4) The political stability of some countries may be doubtful in the eyes of the capitalist class and events could take place which would lead to a wholesale exodus of capital if exchange restrictions were abolished.[12]

The case for the quickest possible relaxation of exchange restrictions is equally convincing:

(1) Exchange control cannot be applied to just one kind of transactions. "If outright capital movements are forbidden there is always a tendency to export all kinds of things which would otherwise not be exported (from jewelry to rare stamps) simply in order to build up balances abroad. All exporters would be compelled to report to the central authority all of the foreign exchange that they acquire. They could not be permitted to leave the proceeds of their exports abroad without proving that they do it for good business reasons and not because they expect a devaluation of their domestic currency.... Under such circumstances the temptation is great not to register the acquisition of foreign exchange at all, particularly since the exporters know better than anybody else that it is almost impossible for the central authority to check on them." [13] These difficulties would remain essentially the same if movements of capital were controlled at both ends.

(2) We know from sad experience how exceedingly tempting it is for governments to use the control over *all* foreign transactions (which they are forced to introduce as soon as they try to control one part of these transactions) for protectionist and

11. See Viner, *op. cit.*, p. 95. Cf. also Paul Einzig, "Exchange Instability after the War," *The Banker*, London, August 1943. "Such control," says Joan Robinson, "would prevent the perverse movements of lending by deficit to surplus countries which bedevilled the exchanges between the wars."—*Op. cit.*, p. 171.

12. See Einzig, *op. cit.*

13. Lutz, *op. cit.*, pp. 17-18.

other purposes. "The instrument is so powerful, so flexible, so versatile, that, once introduced, its operators tend to succumb to the itch to experiment broadly with its possibilities. . . ." [14]

(3) All this would contradict the very intentions of the new plans for international currency stabilization which aim at a reduction "of such foreign exchange restrictions, bilateral clearing arrangements, multiple currency devices, and discriminatory exchange practices as hamper world trade and the international flow of productive capital" (*White Plan* I-5).

Again a compromise must be found. It is obvious that exchange control cannot simply be discontinued at the end of the war; it is equally clear that many countries will not be able to relax exchange restrictions unless they are aided by other countries or by the International Monetary Fund. That stabilization plans which aim at the eventual abolition of exchange control should have to commence in a world bristling with exchange restrictions is, therefore, not so contradictory as it seems. The more successful international monetary cooperation will be, the more will the need for exchange restrictions subside; and the more the countries will learn to cooperate, the less they will be tempted into unilateral or bilateral action, especially if they have to fear concerted action by "the rest of the world." Eventually we could even be hopeful enough to assume that there would be left no adequate motivation for capital flight movements. Any remaining capital flight tendencies could be made unpleasant enough to materially reduce them without forcing the whole system into full-fledged exchange control.

ABNORMAL WARTIME BALANCES

A particularly difficult problem for post-war exchange stabilization has been created through the accumulation of war debts, a considerable part of which is only artificially frozen through exchange restrictions and will tend to flow back to the creditor countries as soon as this opportunity presents itself through the relaxation of exchange control. Great Britain's total external debt resulting from the war and exclusive of Lend-Lease was estimated by Lord Keynes in Bretton Woods to

14. See Viner, *op. cit.*, p. 103.

stand at 12 billion dollars by the end of 1944. Most of this debt is owed to Empire countries. "Even when liberal allowance is made for the fact that some of this sterling debt is of more or less permanent character, enough of it is potentially mobile and straining at leash to create a serious problem—one which cannot be left out of account in considering the question of post-war stabilization." [15]

Several solutions [16] are possible but not equally desirable:

(1) The relaxation of exchange restrictions can be postponed intentionally until the creditors are willing to come to such terms as are agreeable to the debtor country—a solution in which Nazi Germany excelled.

(2) Exchange restrictions can be removed and the exchange rate can be allowed to find its new level in a free market, however low this level may turn out to be. The low exchange value of the country's currency would, then, stimulate exports and impede imports and thus create an excess of exports over imports with which the country could liquidate its debts.

This was England's solution after September, 1931 (when she went off the gold). At that time, however, the short-term debt had been "comfortably covered by longer-term investments" [17] and the exchange rate could not drop very far without causing an increased demand for pound sterling by countries which owed sterling and seized upon the opportunity to get rid of their debts at unusually favorable conditions. Since this automatic protection of the pound will no longer work after the war, Great Britain will find herself in "the role of an uncovered debtor or short-term account" [18] and could only at her peril try to repeat the cure of 1931—a fact which may have contributed more than anything else to the renunciation of free exchanges or of competitive exchange depreciation in England despite the favorable results of this policy for England before the war.

A rapid fall in the exchange rate of a deficit country may not

15. See "Britain's War Debts," *The Economist,* London, August 7, 1943.

16. Some of these solutions would also be of interest in case of reparations.

17. "Britain's War Debts," *The Economist,* London, August 7, 1943.

18. *Ibid.*

be able to equilibrate the free market demand for and the supply of foreign exchange at a level which the authorities could consider reasonable. The fall of the exchange rate could become much rather an incentive to further outward movements of capital (capital flight) than one to increased exports and decreased imports.

(3) An attempt could be made to lower the cost and price level of the country at stable exchange rates. This is the gold standard method of equilibrating the balance of payments. But the gold standard mechanism was not intended to handle the transfer of abnormal balances which, supposedly, could not have arisen under its regime. Even the defenders of deflation as an instrument of adjustments of payments on current account will hardly prescribe for England's post-war exchange problem a combination of complete removal of exchange restrictions, permanently stabilized exchange rates and deflation, since such credit contraction would not only create unemployment in England but would soon diffuse unemployment through the rest of the world.

(4) But after having repudiated deflation as a means to accomplish a quick transfer of abnormal balances under assumption of exchange stability, we have to beware lest we make the mistake of ruling out downward cost adjustments altogether as too dangerous. The long-run solution of the transfer of one-sided payments lies in the achievement of an export surplus. This export surplus will have to rest on relatively attractive prices of the debtor's products at exchange rates which are not abnormally low and this will imply great efforts towards increased efficiency and a tightening of the belt.[19] The other countries will, of course, have to cooperate or will, at least, have to abstain from interference through tariff and other protectionist policies. Nothing, however, can completely eliminate the basic sacrifice which the paying country has to make in form of a lower level of efficiency wages.[20] To overlook this fact completely (as, in-

19. *Ibid.*

20. This, after all, is only the consistent conclusion of foreign borrowing as a method of financing the war: the only case in which the burden of the war is shifted into the future. But only under the assumption of full

deed, some overzealous prophets of expansion seem tempted to do) would be just as wrong as the preaching of deflation at any price.

(5) The most obvious thing to do would be to try to come to a moratorium with the owners of the abnormal balances. The question is only whether the owners of these balances can afford to lock them up "under an agreed programme of funding or long-term expenditure" (*Keynes Plan* VII-34). They may be in need of liquid balances themselves.

(6) A strong creditor country may be willing to make the necessary long-term funds available in its desire to arrange for reasonably stable exchange rates with the country which owes the abnormal wartime balances. This may be the case of the United States and of Great Britain, considering that an insatiable demand for dollars will render it difficult to keep the foreign value of the dollar down while Great Britain will be faced with the opposite problem and considering, furthermore, how important a reasonable stability in the dollar-pound relation will be for the post-war world.[21] It is necessary to emphasize, however, that a loan for the funding of blocked wartime balances is not in itself a permanent solution because it only postpones and spreads over a reasonable period of time the effort of the final pay-off.

(7) Help could be rendered by an International Reserve Bank. Both the White Plan (V-8) and the Canadian Plan (VIII) contain provisions concerning abnormal wartime balances, and

---

employment is our conclusion fully justified. If the extra effort needed to liquidate the abnormal balances should help to create additional employment at a time of underemployment—a not impossible assumption—the standard of living could even be increased because of this incentive to export.

21. See, e.g., Leon Fraser's proposal that "we should enter into a stabilization agreement with Great Britain, open to adherence of other countries, which would include," among other proposals, "a credit to Great Britain in the form of a call on gold in the amount of, say, five billion dollars, on the understanding that neither nation would engage in competitive exchange depreciation and that the dollar-sterling exchange rate would be fixed by mutual agreement. Such a credit would constitute a constructive use of some of our surplus gold."—"Reconstructing World Money," *Proceedings of the Academy of Political Science,* January 1944, pp. 65-66.

the Keynes Plan makes some suggestions in section VII-34. But the Agreement declares tersely that the International Monetary Fund "is not intended... to deal with international indebtedness arising out of the war" (XIV-1).

The White Plan provided that the Stabilization Fund should buy blocked balances to an amount not exceeding (in the first two years of its operation) 10 per cent of the aggregate quotas of the member countries, and that both the creditor and the debtor should agree to repurchase from the Fund during twenty years 40 per cent of the balances held by the Fund with gold and such foreign exchange as the Fund would wish to accept.

The difficulty with these provisions was that the seller of the blocked balances would get from the Fund either its own local currency or foreign exchange but the latter only under conditions similar to those under which he could buy foreign exchange from the Fund anyhow. To be paid for blocked balances in one's own local currency could mean only (a) in case of a surplus country, that the Fund's particular weakness would be emphasized, viz., the scarcity of its resources of surplus currencies (in other words: the creditor country could dodge part of its obligations under the Fund); (b) in case of a deficit country (owning blocked balances), that its purchasing rights from the Fund would be increased, thus increasing the Fund's obligations in relation to its resources.

Since the Fund's resources are rather limited it is better not to unload blocked balances on the Fund at the expense of the Fund's liquidity which is its most precarious problem anyhow.

But we should not forget the International Monetary Fund's indirect contribution to the solution of this problem which consists in the creation of reserves of international money for all member countries which will make the liquidation of frozen balances less urgent than it would otherwise be. Such indirect contribution would also be made by the "Bank for Reconstruction and Development."

XI.

THE ROLE OF GOLD

THE FUND AND GOLD

THE FUND USES GOLD for very important functions. Gold is the international unit of account since the par values of the member currencies are expressed in terms of gold. The member countries have to pay part of their subscription in gold and have, under certain conditions, to sell gold to the Fund for their local currencies. The members also agree to sell their local currencies to the Fund for gold. The Fund tends, whenever feasible, to change its local currency resources into gold in order to be able to buy with gold scarce currencies of surplus countries. Gold performs, therefore, the important function of maintaining the liquidity of the Fund's resources. The member countries are, of course, obliged not to buy or sell gold at a price which differs from the parity by more than a prescribed margin, a provision which introduces artificial gold points, prevents the circumvention of the Fund, and makes competitive exchange depreciation impossible.

But all this does not mean to say that gold standard and gold mechanism are to be reintroduced. The member countries are not obliged to adopt the gold standard though they are free to do so if they wish. To be on the gold standard means that the monetary authority of the country stands ready to buy and to sell gold at a fixed price in unlimited amounts and that it permits free import and export of gold. Owing to the unequal distribution of gold many countries could not go back to the gold standard even if they wanted to; and other countries which could go back may not desire to do so.

The Agreement, furthermore, does not subscribe to the principles of the gold standard mechanism as an *automatic* integrator of the domestic economic policies of the member countries. The similarities between the new international payment organization and the gold standard mechanism are, therefore, superficial.

Lord Keynes considers the Fund proposal as "the exact opposite" of the gold standard. The gold standard "means a system under which the external value of a national currency is rigidly tied to a fixed quantity of gold . . . and it involves a financial policy which compels the internal value of the domestic currency to conform to this external value as fixed in terms of gold" while, "on the other hand, the use of gold merely as a convenient common denominator by means of which the relative values of national currencies—these being free to change—are expressed from time to time, is obviously quite another matter."

Lord Keynes points out, furthermore, that gold has already been dethroned in England as the fixed standard of value and that the Fund proposal "not merely confirms the de-thronement but approves it by expressly providing that it is the duty of the Fund to alter the gold value of any currency if it is shown that this will be serviceable to equilibrium." [1]

In four important respects does the new scheme differ from the gold standard system:

(1) The Agreement makes the reserves of international money at the disposal of the member countries independent of the supply and the present maldistribution of gold. More international currency can be supplied because the reserves of the member countries are pooled and not scattered and because surplus countries can be expected to loan additional local currency to the Fund if they consider such action advisable.

(2) The International Monetary Fund can induce member countries to take appropriate measures as these countries depart from equilibrium. Conscious world credit control can, thus, supplant the purely automatic adjustments of the gold flow.

(3) The International Monetary Fund does not have to maintain rigid exchange rates. It provides an orderly and agreed

1. House of Lords, May 23, 1944.

upon method to adjust exchange rates which are out of line with price and cost levels without the danger of competitive depreciation.

(4) The International Monetary Fund can introduce exchange restrictions if abnormal conditions make exchange control desirable.

THE KEYNES PLAN AND GOLD

We remember that the Keynes Plan is based on the overdraft principle and does not require contributions in gold or in national currencies. International payments through the Clearing Union consist simply in the simultaneous creation of debit and credit balances. Gold is not essential, has no important function to fulfill and only distorts the admirably simple structure of the Keynesian scheme.

Bancor is fixed in terms of gold, *but not unalterably* (I-2) and, for the same reason as in the Agreement, the member countries shall not purchase gold at a higher price than corresponds to the parity of their currencies with bancor and the parity of bancor with gold (II-6-4).

"A member State shall be entitled to obtain a credit balance in terms of bancor by paying in gold to the Clearing Union for the credit of its clearing account. But no one is entitled to demand gold from the Union against a balance of bancor . . ." (II-6-10). Thus the Keynes Plan allows gold to expand the quantity of international money but not to contract it. Since the mechanism of the Keynes Plan provides for an upward revision of the quotas of the member States as international trade expands, no purpose whatsoever is served by introducing gold production as an expansionist device.

Why, then, is gold included in the provisions of the Keynes Plan? Section VI-26 gives the following reasons:

(1) "Gold still possesses great psychological value which is not being diminished by current events; and the desire to possess a gold reserve against unforeseen contingencies is likely to remain."—This first point is meaningless in the context of the Keynes Plan unless it simply expresses political expediency and the fear that either not enough important countries may be

tempted to enter the Union or that, though members, the countries would play an independent gold standard game outside the Union.

(2) "Gold also has the merit of providing in point of form (whatever the underlying realities may be) an uncontroversial standard of value for international purposes, for which it would not yet be easy to find a serviceable substitute."—But since the Keynes Plan introduces a new international monetary unit—bancor—the use of gold as international unit of account is quite unnecessary.

(3) "Moreover, by supplying an automatic means for settling some part of the favorable balances of the creditor countries, the current gold production of the world and the remnant of gold reserves held outside the United States may still have a useful part to play."—This point suggests that Lord Keynes considers it quite desirable that the tendency towards gold imports by the United States should continue, a tendency which, implicitly, is rather sharply criticised by other sections of the Keynes Plan (e.g., Preface 5; I-1-c; IV-11; IV-13; IV-14). Obviously Lord Keynes no longer considers a one-sided gold flow as deflationary since it would be superimposed upon the credit facilities of the plan. But for the United States it would be a reason for alarm lest she be faced with the prospect of becoming forever the world's dumping ground of gold.

(4) "Nor is it reasonable to ask the United States to demonetise the stock of gold which is the basis of its impregnable liquidity. What, in the long run, the world may decide to do with gold is another matter."—The United States' impregnable liquidity rests on a much stronger foundation than gold, viz., on her position as a creditor country. It is, however, somewhat alarming from the viewpoint of the United States to be invited, first, to absorb plenty of more gold and, then, to face with equanimity "what, in the long run, the world may decide to do with gold."

This somewhat mortifying attempt to rescue the role of gold in a plan which is supremely independent of gold is the weakest part in the Keynesian scheme. To what strange results it might

lead has been shown by Professor Friedrich A. Lutz.[2] To get conditions in which the gold stocks could become really useful to the United States we should have to make the rather unreal assumption of a strongly inflationary tendency in the United States, compared with the rest of the world, at stable exchange rates. In this case the Keynes Plan might automatically, through the working of its own mechanism, be replaced by the gold standard. With a strongly passive balance of payments the United States would either directly pay in gold or acquire bancor balances through gold deposits and draw against them in favor of countries with active trade balances. First these countries would discharge their debt with the Union, then they would accumulate credit balances backed by gold. As these balances, originating in gold deposits, would grow, the aggregate amount of international money (balances backed by gold plus original quotas) could become dangerously large. Then the Union would make use of its power to reduce the quotas and when, in the extreme case, the quotas were reduced to zero, the original Keynes Plan would actually have been replaced by the gold standard.

GOLD PRODUCTION

How gold production would be affected by the working of the International Monetary Fund depends on the following circumstances. If the price of gold in terms of member currencies were reduced, gold production would, of course, tend to fall off while, on the other hand, a uniform depreciation of all member currencies would tend to stimulate gold mining. But an agreed uniform change in the gold value of member currencies can only be made "provided each such change is approved by every member which has ten per cent or more of the total of quotas" (*Agreement* IV-7). Under this condition it is most unlikely that the member currencies will be uniformly appreciated in terms of gold[3] and a uniform depreciation is not very probable either.

2. See *op. cit.*, pp. 8-9.

3. Article IV-7 of the Agreement states that the par value of a member's currency shall not be changed in connection with a "uniform change in par values" if "the member informs the Fund that it does not wish the

The effect on gold mining of numerous depreciations of individual currencies would depend on whether or not these depreciations would always correspond exactly to upward changes in price and cost levels. If a downward adjustment in the par value of a country's currency merely compensates for increasing domestic prices as, indeed, it is supposed to do, the depreciation would tend to be neutral in its effect on the gold mining industry.

Since the Agreement establishes gold as international *tertium comparationis,* since the Fund is always more than willing to buy gold to improve its own liquidity, and since provision IV-7 makes a uniform change in the gold value of the member countries all but impossible, we may presume that the adoption of the new scheme would greatly strengthen the position of gold and assure the gold mining industry of a steady market.

Is this, in itself, an advantage or a disadvantage?

Dr. Hardy believes that "the only merit of the gold standard" is that it reduces the need for credit management and that "when gold no longer performs that service gold mining becomes sheer waste."[4] This statement, is, strictly speaking, only correct under conditions of full employment and for the world as a whole.

It can be argued that the gold industry exerts a kind of parachute effect upon the economy in times of deflation and depression (provided that we assume a stable gold price). If prices in general go down, it becomes cheaper to produce gold while the price of gold—the monetary unit—remains stable. This situation stimulates gold production and creates employment at a time when employment and the national income are on the downgrade.

Dr. Hardy himself reminds us that "under the conditions of

---

par value of its currency to be changed by such action." It is difficult to see how, then, in case of a general appreciation of "all" currencies, competitive advantages can be refused to those members which declare that they want to maintain the par value of their currencies. For all practical purposes this would be equal to competitive exchange depreciation. This clause would, therefore, prevent a less than uniform appreciation.

4. See Charles O. Hardy, *The Postwar Role of Gold,* The Monetary Standards Inquiry, No. 8 (New York, January, 1944), p. 20.

the middle thirties the gold mining industry became a gigantic boondoggle which might be justified on the grounds that are generally adduced in favor of putting men at work digging holes in the ground rather than supporting them in idleness."[5] Mrs. Robinson, too, emphasizes the importance of gold production as "a certain corrective to world slum conditions."[6]

If resources would not be employed at all, it can hardly be said that the same resources, when employed in gold production, would be wasted. The argument, furthermore, holds true for a country which, in times of unemployment, acquires gold in exchange for commodities which would not have been produced at all had it not been for the inflow of gold. Both the gold producing and the gold buying country, as a matter of fact, will improve their respective positions by more than the value of the gold produced or acquired, since they will enjoy a beneficial indirect effect in the form of an extra contribution to income and employment owing to the increased demand of those who were put to work (multiplier effect).

An even stronger case for gold and the maintenance of a world market for gold can be made by a gold producing country which has, at the same time, a well-nigh insatiable demand for imports. If a country should have an absolute advantage over other countries in the production of gold, this country is, of course, from a nationalist viewpoint, interested in the maintenance of that advantage. It produces international money, viz., gold, more cheaply than many other export products and it enjoys the great and unique advantage of selling a commodity, viz., gold, which owns the unsurpassed quality of being salable in unlimited amounts at a fixed price everywhere.

It is, therefore, perfectly understandable that a country in the position described above will be an advocate of a solution of the international monetary problems which promises to maintain a world market for gold at a fixed price.

5. *Ibid.*, pp. 24-25.
6. Robinson, *op. cit.*, p. 172.

RUSSIA AND GOLD

Russia, the second largest gold producer, finds herself exactly in this position. She is interested in the maintenance of an industry which, under gold standard conditions, is ideally suited to produce foreign exchange at low costs and with no risk involved. Nothing could be more desirable for a planned economy than a reduction of the risks which arise when the planned economy meets with the uncertainties of the markets of the unplanned economies.

Professor Varga pointed out that Russia "is not impressed by the international bank or stabilization fund proposals of the Keynes and White schemes" and that "if all the Soviet Union's trade with the rest of the world could be done on the basis of a fixed value gold currency, this would undoubtedly facilitate trade operations." [7] *The Economist*, commenting on Professor Varga's article, reminds us, furthermore, that "for Russia, a return to the gold standard would have none of the implications which such a move would have for a country operating a relatively free economy. The fixed external value of the Soviet rouble has at no time maintained a close relation to its internal purchasing power. The problem of maintaining equilibrium with international cost and price structures hardly arises in a wholly planned and socialized economy, where the State undertakes the whole of foreign trade." [8]

All that is, of course, quite correct. Deflationist consequences of the gold outflow have no meaning for a gold producing, planned economy, nor do the Russians have to consider gold production as an unproductive digging of ditches, since they get the commodities and the capitalist rest of the world gets the yellow metal. Gold production provides Russia "with a means of buying useful materials and equipment from the foolish capitalist world without sacrificing wheat and timber which she can consume at home." [9]

But should we really go as far as *The Economist* and say that

7. See *The Economist*, December 11, 1943, p. 785.
8. *The Economist*, December 11, 1943, p. 785.
9. Robinson, *op. cit.*, p. 172.

"the Soviet experts are bound to be profoundly disinterested in the technical devices by which the Keynes and the White plans propose to maintain international discipline in matters of currency policy"? True enough, the Russian economy is completely insulated against "outside dictation." But the Russians are very much interested in whether or not the gold price is fixed unalterably; and it can hardly be a matter of indifference to the Commissar of Foreign Trade whether or not the capitalist countries are able to maintain international monetary discipline and to create normal and expanding trade relations.

That the Russian experts were willing to accept the Agreement is in all probability due to the fact that the position of gold in the International Monetary Fund is comparatively strong and that the Fund ensures a world market for gold at a price which could be changed only with Russia's agreement (under the plausible assumption that Russia's quota would always be more than ten per cent of the aggregate of quotas).

THE CONSERVATIVE DEFENSE OF GOLD

Russia's position is one of hard-boiled realism and her preference for a strong position of gold is certainly not dictated by a belief in the intrinsic value of gold.

The friends of gold in the capitalist countries, on the other hand, are not always realists. They suffer from nostalgia for the good old *laissez-faire* world which is definitely *passé*. They have some good points to make, to be sure, but they tend to forget that the world of today does no longer fit their assumptions. Their arguments are still impressive because they are simple and easily understood. But this simplicity is deceptive. And their criticism of the new plans is often unconsciously unfair because they do not attempt to carry their own proposals (which lack utterly in originality) beyond some very generalizing suggestions.

In Chapter II we discussed the advantages and the defects of the old gold standard mechanism. Now we shall try to find out whether or not the advocates of the readoption of the gold standard propose to change the old mechanism sufficiently to avoid these defects.

The post-war international standard must, according to Professor Kemmerer,[10] have the confidence of the people. The people believe in gold because it has "intrinsic" value, because no other currency system can be made so simple, so easily understood, and because no other system could be kept equally free from the blighting hands of politics.

On the basis of these considerations Professor Kemmerer arrives at "a few postulates of the post-war international gold standard" which repeat, in the main, the well-known essentials of the full fledged gold standard, viz., the definition of the countries' currency units in terms of gold, convertibility of money into gold and free export and import of gold. Added are three suggestions which try to modernize the gold mechanism and to adapt it to post-war conditions. These are: (1) the suggestion that the gold exchange standard should be used where return to the gold coin or gold bullion standard is not possible; (2) the suggestion, already to be found in the Macmillan Report, that "among the central banks there should be maintained a close though largely informal and non-statutory cooperation directed towards the orderly functioning of the international exchanges"; (3) the suggestion that "there should be an international bank of some kind through which the central banks can cooperate in collecting international monetary and financial statistics and in effecting international payments, and which, when needed, can take the leadership in measures to enable strong countries to help weak ones in the maintenance of their monetary standards."

In criticizing Professor Kemmerer's arguments and postulates (which stand for many similar ones in the present discussion), we assume that they are meant to contradict, in detail as well as in general philosophy, the new proposals.

(1) *The "intrinsic" value argument.* This argument is generally overemphasized. In using it we should not forget the decisive fact that the height of the intrinsic value of gold is

10. See Edwin Walter Kemmerer, *High Spots in the Case for a Return to the International Gold Standard,* Economists' National Committee on Monetary Policy, New York City, 1943.

today the artificial product of the standing offer by the United States Treasury to buy gold at the price of $35 an ounce. If gold is worth what it is only because it is redeemed in dollars, it is rather strange to be told—as an argument for gold—that "all incontrovertible paper currencies have depreciated in terms of gold,"[11] that our whole credit structure is only sound when it rests "on the intrinsic usefulness and value of the money metal,"[12] and that gold plays today "a most essential role in supporting the nation's enormous and ever-increasing debt."[13] Concerning the Agreement and the Keynes Plan a reminder may be in order that both maintain the "intrinsic" value of gold because the par values of the member currencies will be expressed in gold. But the fact that these prices may be altered seems to be inconvenient to those who want us to believe in the intrinsic value of gold as some independent and mystic quality of the yellow metal.

(2) *The simplicity argument.* This argument is not strong. People do not believe in gold because they "easily understand" the gold standard mechanism. Very few people know how complicated a modern monetary system is. If we should have to remain within the limits of what is easily understandable, we should have to return to the exclusive circulation of full-bodied coin. The simplicity of the gold standard, furthermore, rests on the simplifying assumptions of its advocates. But not a single one of the problems which the Agreement tries so courageously to tackle is solved by the device of ignoring it. And this, unfortunately is, what many gold enthusiasts are doing. We are not told by them how the correct exchange rates (which are to be stabilized permanently) are to be found, how competitive depreciation and other unilateral and bilateral devices are to be avoided, how adequate reserves of international money are to be made available to deficit countries, etc. This does not mean

11. See Walter E. Spahr, *Alternatives in Postwar International Monetary Standards,* Monetary Standards Inquiry, No. 7 (New York, January, 1944), p. 5.

12. *The Guaranty Survey,* September 28, 1943, p. 2.

13. John Tom Holdsworth, "Gold at the Peace Table," *Commercial and Financial Chronicle,* September 2, 1943.

to say that a gold standard solution would be impossible; only the solution would have to be just about as complicated as, and basically very similar to, the new plans.

(3) *The laissez-faire argument.* This argument rests (just as does argument 2) on the assumption that the gold standard mechanism works automatically. Professor Kemmerer admits, of course, that all modern currencies are more or less managed. But he asks that "whatever management we have should be superimposed upon a monetary system that is fundamentally automatic in its operation." This is probably the most essential point for the friends of gold. They want gold, as Professor Kemmerer frankly admits, because they do not trust governments. They believe that, once we have subscribed to the rules of the gold standard, we have renounced the new-fangled ideas of government deficit spending and pump-priming. Then, they hope, we shall live again in an orderly world in which budgets are balanced and price levels and exchange rates are stable. The defenders of the old gold standard do not want to make concessions which would relax the tight control over national credit policies which is implied in the rules of the gold standard game. The new plans, on the other hand, are essentially attempts to change these gold standard rules which they consider as dangerous and unacceptable especially under the conditions which will prevail in the post-war world. While we have already pointed out that the expansionist (inflationary) tendencies of the Keynes Plan may, indeed, go too far, we cannot agree with the old fashioned standpoint that only balanced budgets are indications of sound economic policy.

(4) *The gold exchange standard argument.* This argument advises countries which are short of gold to adopt a makeshift gold standard by linking their currencies with currencies of gold standard countries. The money of the gold exchange standard country is convertible not into gold but into foreign exchange which, in turn, can be converted into gold. This device is not new. It was widely used after the first World War. Since the gold exchange standard is recommended by those who believe in the automatic working of the gold standard, who are afraid of credit expansion and are for the maintenance of multi-

lateral trade relations, a few warning remarks will be in order.

(a) The use of foreign currency rather than of gold as "basic" money impairs the gold mechanism because the currency of country A, the gold standard country, has an entirely different importance in A than in B, the gold exchange standard country. If this currency flows (like gold) from B to A, the effect will be hardly noticeable in A but very strong in B, where credit will be contracted just as if gold had left the country. The gold exchange standard tends, as we see, to stress the basic weakness of the gold standard mechanism, viz., its unsymmetrical character.

(b) The gold exchange standard could, theoretically, be used for expansionist (inflationary) purposes because there is actually no longer a metallic limit for expansion "since the same gold would form the basis for credit expansion in more than one country." [14]

(c) The experiences of the inter-war period show that the adoption of the gold exchange standard by many countries was instrumental for the formation of monetary blocs—a development not necessarily compatible with multilateral trade relations.[15]

(5) *The cooperation argument.* When Professor Kemmerer suggests cooperation between the central banks, it seems, momentarily, as if he were closely approaching the new plans. And since he derives his suggestion from the Macmillan Report, he seems to advocate quite a substantial degree of international monetary management (which in the Macmillan Report goes actually far beyond the old automatic gold standard mechanism). But Professor Kemmerer's emphasis on *informal* and *non-statutory* cooperation together with the constant stress on the *automatic* character of the gold mechanism destroys our illusion very soon.

(6) *The international bank argument.* An international bank as proposed by advocates of the gold mechanism is likely

14. See Gottfried von Haberler, *The Theory of International Trade* (New York, Macmillan, 1937), p. 48.

15. See J. B. Condliffe, *The Reconstruction of World Trade* (New York, W. W. Norton, 1940), pp. 317-18.

to be a rather anaemic affair. In a full-fledged automatic gold standard mechanism there is not much room for a real bank of central banks which would be the very contradiction of the request for informal and non-statutory cooperation of central banks.

But, in criticizing the new plans, the advocates of the gold mechanism have the duty to show that their solution is preferable. They may believe that they are relieved from this task by simple reference to the working of the gold mechanism in earlier days. This attitude will not do. Dr. Hardy states correctly that "the existing stock of gold must be redistributed in such a way that at the outset all member countries will have a sufficient gold reserve and no country will have a sufficient excess reserve to free it from the requirement of conformity to the working of the standard." [16] Excess reserves of gold are, according to Dr. Hardy, incompatible with the effective operation of the gold standard since "the various money markets must not be insulated from the effects of gold movements." [17]

No solution for this basic difficulty has as yet been proposed. The introduction of the gold exchange standard would, as we have seen, only emphasize the danger of an unsymmetrical working of the gold mechanism. Before a real redistribution of the gold stock has been achieved, the gold-holding surplus countries would be in a position of following an entirely independent credit policy while the deficit countries on the gold exchange standard would be asked to bear the brunt of the adjustment burden. Help could, of course, be forthcoming from the surplus countries at their discretion. But this help could also be used to strengthen the trend towards monetary blocs which is already implied in the very idea of the gold exchange standard.

16. See Charles O. Hardy, *op. cit.*, p. 14.
17. *Ibid.*

XII.

KEY COUNTRIES AND MONETARY BLOCS

THE PROBLEM OF TRANSITION

WE RETURN NOW to a problem which was briefly introduced at the end of Chapter IV, the question: "Is it wise to attempt to deal both with the problems of the transition period from war to peace and with longer-run currency stabilization under a single plan?"[1] Professor Williams believes that "a clear and unmistakable separation between these two problems" is "the greatest single prerequisite for the success of any plan for currency stabilization."[2] He argues that there is a fundamental conflict between the requirements of the transition period and those of longer-run monetary stabilization" and that "any plan that serves one purpose well is bound to fail in the other."[3]

Relief and rehabilitation together with the liquidation of the abnormal war-time balances will need funds of very large dimensions. If these needs are met "by a method which would expand American bank reserves and deposits, already greatly enlarged by the war" the danger of inflation would be great according to Professor Williams.[4] Furthermore, the transition period would put the Clearing Union or Fund into a chronic lopsided condition. "Some countries would have run up large debits and other countries (mainly the United States) largely credits, and each group of countries would then be expected to pursue the policies of adjustment which are required by the

1. Williams, *Foreign Affairs,* January 1944, p. 234.
2. *Ibid,* p. 235.
3. *Ibid.*
4. *Ibid.*

plans—and this not by reason of anything arising out of their, by then, more normal situations but because of the past misuse of the stabilization fund." [5]

Professor Williams' argument has been supported by Professor Viner who believes that "the handling of the emergency problems of the transition period" would "put a curse on the agency from the start" [6] and by Mr. Riddle who predicts that "any such mechanism as that proposed by White or Keynes would be badly battered by the tidal waves that follow in the wake of war." [7] A similar attitude is also implied in Mr. Fraser's proposals.[8]

Much can be said against these arguments though we can, of course, not deny that it is very legitimate to ask whether or not the plans are premature.

Professor Robertson suggests that, painful as it may be to the purist, this partial blurring of outlines cannot be avoided in the world as it exists today. If the tidal waves after the war will batter the ship, the ship must be sturdily built. Or to use Professor Robertson's delightful simile: "It *is* an umbrella we are constructing, not a bomb-proof shelter, but a specially reinforced umbrella capable of withstanding a stiff shower of hail, or even of cats and dogs." [9] That the transition period will pose much greater problems than a normal period does certainly not prove that during this trying time the countries could get along without an international payment mechanism. Relief and rehabilitation as well as loans for reconstruction, while indispensable for the transition period, are not a sufficient substitute for an international payment and stabilization mechanism or for adequate reserves of international money.

We must, of course, be careful "not to clutter up our machine of short-term credit with things which should manifestly be done by way of gift or of long-term loan." [10] But we can easily

5. *Ibid.*, p. 236.
6. See Viner, *op. cit.*, p. 105.
7. See Riddle, *op. cit.*, p. 22.
8. See Leon Fraser, "Reconstructing World Money," *Academy of Political Science Proceedings*, January 1944, pp. 63-66.
9. Robertson, "The Post-War Monetary Plans," *loc. cit.*, p. 357.
10. *Ibid.*

prove that the authors of the new plans are anxious to avoid this obvious mistake.[11]

Secretary Morgenthau emphasized in the Foreword to the American plan "that an international stabilization fund is only one of the instrumentalities" and that "other agencies may be needed to provide long-term international credit for post-war reconstruction and development, to provide funds for rehabilitation and relief, and to promote stability in the prices of primary international commodities" (*White Plan,* Foreword, p. ii).

Lord Keynes said in his maiden speech in the House of Lords (May 18th, 1943): "It is most important to understand that the initial reserve provided by the Clearing Union is not intended as a means by which a country can regularly live beyond its income and which it can use up to import capital goods for which it cannot otherwise pay. Nor will it be advisable to exhaust this provision in meeting the relief and rehabilitation of countries devastated by war, thus diverting it from its real, permanent purpose. These requirements must be met by special remedies and other instrumentalities."[12]

Section X-42 of the Keynes Plan states that "if the intention is to provide resources on liberal and comprehensive lines outside the resources made available by the Clearing Union and additional to them, it might be better for such specific aid to take the place of the proposed overdrafts during the 'relief' period of (say) two years. . . . Nevertheless, the immediate establishment of the Clearing Union would not be incompatible with provisional arrangements, . . . qualifying and limiting the overdraft quotas."

The Canadian Plan is anxious to assert that "the establishment of an international monetary organization is no substitute for the measures of international relief and rehabilitation which

11. Only the *Dewey Resolution* (78th Congress 2d Session, H.J. Res. 226) mixes the different purposes together by providing for a "central reconstruction fund (of 500 million dollars) to be used in joint account with foreign governments for rehabilitation, stabilization of currencies, and reconstruction, and for other purposes."

12. See *Parliamentary Debates on an International Clearing Union,* British Information Services, July, 1943, p. 77.

will be required as the war draws to its conclusion and afterwards; and in the view of the Canadian experts any monetary organization which is set up should not be called upon to finance transactions of this nature" (*Canadian Plan,* General Observations 4).

The Joint Statement and the Agreement, finally, declare that "the Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of the war" (*Joint Statement* X-1; *Agreement* XIV-1).

Lord Keynes referred to the quotas of the Joint Statement as "an iron ration to tide over temporary emergencies of one kind or another." While this ration is "obviously not large enough . . . to live upon during the reconstruction period," he said, "it is large enough for the purpose for which it is intended." [13]

It can, therefore, hardly be said that the new plans are not aware of the somewhat dangerous overlapping of short-term and long-term demands for loanable funds during the transition period, though the new plans recognize realistically that both long-term *and* short-term funds will have to be made available —a fact which the overcautious purists seem to overlook.

The currency stabilization program might possibly become a catch-all for any inadequacies in the transition program.[14] But what is possible is not necessary, and a device serving as a catch-all might still be much better than no such device. After all, nothing prevents the parties concerned from converting an accumulating short-term debt into a long-term debt, a policy actually hinted at in Section III-7 of the Keynes Plan though not actually included in its mechanism. Since the long-term demand for loanable funds may not be known or an adequate supply not be immediately available for each member country, it is most important, especially during the transition period, that substantial reserves of international money should be made available or, in the words of Sir Kingsley Wood, "that countries whose economy has been gravely dislocated and damaged by the war, should have some temporary international monetary

13. Speech before the House of Lords on May 23, 1944.
14. See J. H. Williams, *Foreign Affairs,* January 1944, p. 237.

facilities to enable them to start up into national trading without undue delay." [15]

If the cooperation between the relief and reconstruction agencies on the one side, and the international credit pool on the other, would not function properly right way, the Clearing Union or Fund would, of course, be put into a lopsided condition. But even then it would not be necessary to cure this lopsidedness through the application of the mechanism of the plans if long-term loans can be arranged. It is most unlikely that the authors of the new plans would recommend painful adjustment processes (for debtors and creditors alike) if, during the transition period, the international monetary organization should actually have to serve as stopgap for temporarily lacking accommodations by the contemplated relief and reconstruction agencies. We can assume that these agencies will, later on, help to eliminate chronic debit and credit balances through long-term loans or other arrangements provided that these balances were due to transition difficulties. Why then construe a conflict between agencies which are obviously meant for cooperation in the solution of post-war financial problems? Referring to the fact that the Fund would at first "rapidly lose gold, dollars and dollar securities and build up its holdings of the national currencies and national securities of the countries impoverished by the war," Professor Condliffe states quite correctly that "this is the reason for its creation, to tide over a period of abnormal strain and prevent either indiscriminate lending or wholesale exchange depreciation." [16]

Professor Williams, Mr. Riddle, and many others doubt the workability of an international stabilization scheme because of the enormous difficulties in determining normal rates of exchange. Professor Williams, furthermore, suggests that exchange control measures make it unnecessary to worry too much about currency stabilization right after the war.[17]

We have already seen [18] that adoption of an international

15. Cf. *Parliamentary Debates*, p. 6-7.

16. See John B. Condliffe, *Money and International Trade*, The Monetary Standards Inquiry, No. 10 (New York, 1944), p. 10.

17. *Foreign Affairs*, January 1944, p. 237.

18. Cf. above Chapter X, pp. 134-38.

currency stabilization scheme does not require immediate relaxation of all exchange control measures and that, on the other hand, there is hope for such relaxation only if every country is started off after the war "with a stock of reserves appropriate to its importance in world commerce, so that without due anxiety it can get its house in order during the transitional period to full peace-time conditions" (*Keynes Plan* I-1-e). Professor Williams fails to show how normal conditions concerning balances of payments, exchange rates, price levels, etc. can be created without the immediate availability of a plan for international monetary cooperation; or else his transition program has to contain a currency program of its own and we should be told in which respect it differs from Lord Keynes's or Dr. White's propositions. If such a monetary transition program were good enough to weather the storm of the post-war period, it would most certainly be able to handle the international payment problems of more normal times. Questions of purity, beauty, and simplicity cannot possibly count. We shall gladly rewrite and simplify the currency stabilization plan ten or twenty years from now when it has helped us to reach safe shores.

Finally, "knowing what we know of the centrifugal forces at work among the nations of the world, of the ease with which wills tire and good intentions fade, can we doubt that in this, as in the political field, it would be wise to lay the foundations while imaginations are active and hopes are high?" [19]

THE KEY COUNTRIES APPROACH

Closely connected with the problems of transition and of timing is the proposal that international currency stabilization could best be effected "by a more gradual 'key countries' approach, beginning with the dollar-sterling rate and tying in, as circumstances warrant the other currencies significant for international trade." [20] This suggestion was first made by Professor Williams [21] and has been widely acclaimed and criticized.

19. Robertson, *op. cit.*, p. 357.
20. See *Foreign Affairs,* January 1944, p. 234.
21. See *Foreign Affairs,* July 1943, p. 654.

The arguments in favor of the key countries approach are as follows:

(1) This approach, it is suggested, would allow the countries time "to work out their problems one by one until general stabilization is attained. The emphasis would be placed upon remedying the basic causes of disequilibrium in each country rather than undertaking general stabilization before the causes of instability are attacked." [22]

(2) The key countries approach, we are told, is the only practical or realistic approach. Direct cooperation between the United States and Great Britain is either all that is necessary (because the other countries will be eager to peg their exchanges to a firm pound-dollar basis) or at least all that can momentarily be achieved. "If the dollar-sterling rate could be stabilized," says Mr. Riddle "it would form a strong nucleus around which general stabilization efforts could center." [23] Professor Cassel and Mr. Leon Fraser have made similar suggestions.[24]

Arthur Nussbaum doubts whether "a long-term treaty with

22. See Riddle, *op. cit.*, p. 32. The key countries approach is, of course, meant to lead to an international monetary organization; otherwise it would hardly be referred to as an "approach." But in its initial stages the key countries approach cannot be distinguished from the attitude of those who believe that "the most practical method of assuring international monetary cooperation is through sound economic, budgetary, credit, and currency policies *within each nation*," and that if these policies exist "a huge international stabilization fund will be unnecessary" while, when they do not exist, "an international monetary fund, no matter how large, will be worse than ineffective." When nations wish to borrow abroad, we are told, it should be done through private channels, first, because "private lenders, risking their own funds, can judge the probability of repayment with a purely business eye," second, because private lenders can require that the borrowing country should "change its economic or financial policies in this respect or that," and thirdly, because this "indication of distrust" would be less embarrassing for both countries concerned if it is the lending country's private industry rather than its government which imposes onerous conditions. (See editorial, "A World Monetary Plan," *The New York Times*, April 24, 1944.)

23. Riddle, *op. cit.*, p. 32.

24. Gustav Cassel, "The World Currency Problem," *Quarterly Review*, Skandinaviska Banken, Stockholm, October 1943, pp. 69-73; Leon Fraser, "Reconstructing World Money," *Academy of Political Science Proceedings*, January 1944, pp. 371-74.

a multitude of reliable and unreliable partners is the commendable solution for a beginning." Modern experience rather suggests, he says, "informal or easily dissoluble agreements among a limited number of participants united on the solid ground of common interests and inspired by international good-will. Such tentative agreements under which much of the official plans might be used as statements of policy, may then gradually solidify by experience and eventually crystallize into more rigidly defined and more comprehensive conventions."[25]

Professor Williams believes that the key countries approach "is closer in conception than either the Keynes or White plan to the way the gold standard actually worked, around England as the central country; . . . whereas . . . those plans have a closer family relationship with what might be called the textbook type of gold standard, which implied that monetary stability was maintained by the compensatory action of a large number of countries of equal economic weight."[26]

The reader will notice that, strictly speaking, the key countries approach means much more than just the proposal that the countries should join an international system one after the other, when they are ready to join, and that it is not only to be interpreted as just another road to the aims for which the White and Keynes plans stand. The "nucleus" would be more than a first toehold in the setting-up of an international currency system. It would be a core of permanent leadership around which smaller countries would group themselves as monetary satellites.

(3) The key countries approach is, therefore, very similar to a monetary bloc proposal. Many countries, we are told, are already stable in relation to dollar or pound "and other currencies could gradually make the necessary adjustments and ally themselves with these two important currencies.[27] Professor Williams admits that his key countries approach wants to stabilize the principal currencies "each of which would be central

25. "International Monetary Agreements," *The American Journal of International Law,* April, 1944, p. 257.

26. *Foreign Affairs,* July 1943, p. 654.

27. Riddle, *op. cit.,* p. 32.

for an area of trade" and that this has some similarity with a proposal by *The Economist* for "a system of currency groups with substantial freedom of payment within each group and controlled—but not restrictively controlled—exchanges between group and group." [28] But after having admitted this similarity, Professor Williams hastens to emphasize that his aim would be "a truly multilateral system" while *The Economist* only expresses the hope that the relations between the sterling group and the dollar group would not be necessarily hostile.

We see that the key countries approach which seems, at first, to indicate only a slight difference in procedure, actually proposes that we should recognize, frankly and realistically, existing groupings and relationships, so that a smaller country would join a multilateral clearing system through its membership in a narrower group rather than as a direct and independent member of equal rights.

Much can be said against this attitude which, though it aims at multilateralism, comes dangerously close to a system of monetary blocs or even to bilateralism.

(1) Taken simply as a suggestion that the different countries should join a multilateral system when they are ready, i.e. when the basic causes of disequilibria are remedied in each country, the key countries approach denies to those countries which are most in need of it (and when they are most in need of it) the help which an international monetary organization could offer. But "the very fact that many of them will be in a sorry condition after the war, not capable of playing their full part at once in an international system, is surely an argument for *organizing* their return to such a system rather than leaving them to scramble back as best they may." [29]

(2) The key countries are interested in the stability of the smaller countries. These smaller countries are Great Britain's and the United States' customers, suppliers and competitors on an important scale and the key countries are therefore "deeply

28. See *Foreign Affairs*, January 1944, p. 234. Professor Williams refers to an article "Post-War Currency" in *The Economist*, August 28, 1943, p. 261-62.

29. Robertson, *op. cit.*, p. 355.

affected by the state of their financial health."[30] The small countries, furthermore, "have an important positive contribution to make to the financial ordering of the world, not only in resources, but in experience and personnel."[31]

(3) Since large credits would be involved in the stabilization of the key currencies and "as each major country must carry the burden of its satellites . . . such credits would . . . be just as difficult to make and to accept as credits to or from an international agency, and would certainly seem to be just as heavily loaded with political dynamite."[32] An international agency would offer the advantages which a pooling of reserves implies and would open up a direct and unequivocal approach to a multilateral system.

(4) An international system composed of key countries and their satellites rather than of independent members could easily crack and fall apart into monetary blocs which, by definition, violate the idea of strict multilateralism.

(5) Monetary blocs will be less inviting to many smaller countries than an international organization. Blocs easily imply the domination of the smaller countries' financial and economic life and Professor Robertson is therefore right in assuming "that in the present state of world opinion the worst way to offer Anglo-American leadership to the nations in any field is to seem to be imposing it on them. That leadership must develop *within* the framework of a United Nations—and ultimately of a still broader—system. Offered in that way it will be accepted; imposed from the outside with a 'leave this job to London and New York, who know all there is to be known about it' air, it will be resented and kicked against."[33]

(6) This very same resentment has even been shown by English politicians who assume correctly that Great Britain would find herself in such a set-up in the role of a junior partner

30. *Ibid.*

31. *Ibid.*, pp. 355-56; see also J. B. Condliffe, *Agenda for a Postwar World* (New York, W. W. Norton, 1942), p. 78.

32. See J. L. Ilsley, "The Problem of Monetary Stabilization," *Academy of Political Science Proceedings*, January 1944, p. 61.

33. Robertson, *op. cit.*, p. 356.

"fettered in a strait-jacket of gold." [34] For whatever it is worth, this argument shows at least that the crack in the system might run straight through the nucleus itself, viz. the relationship between the United States and Great Britain. The smaller countries, furthermore, might not peg their exchanges to the dollar-sterling basis but rather either to the dollar or to the pound (if, indeed, they did not already join as satellites) and might, therefore, serve as weights which could widen the rift between a dollar and a sterling bloc.

MULTILATERALISM

Interpreting his Clearing Union to the House of Lords, Lord Keynes said that the Union's principal object could be explained in the single sentence: "To provide that money earned by selling goods to one country can be spent on purchasing the products of any other country. In jargon, a system of multilateral clearing." [35] Multilateralism, therefore, is the basis of the Keynes Plan. We remember, furthermore, that it is the aim of the International Monetary Fund "to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade" (I-iv).[36]

Both the Keynes Plan and the Agreement are compatible with a certain degree of monetary regionalism. The Keynes Plan does not find it necessary to "interfere with the discretion of countries which desire to maintain a special intimacy within a particular group of countries associated by geographical or political ties, such as the existing sterling area, or groups, like the Latin Union of former days, which may come into existence covering, for example, the countries of North America or those of South America..."(V-23). The Keynes Plan maintains,

34. Mr. Boothby, *Parliamentary Debates*, p. 43.
35. *Parliamentary Debates*, p. 76.
36. In his recent statement on United States foreign policy Secretary Hull said (March 21, 1944): "Excessive trade barriers of the many different kinds must be reduced.... Equally plain is the need for making national currencies once more freely exchangeable for each other at stable rates of exchange...."

furthermore, that "there is no reason why such countries should not be allowed a double position, both as members of the Clearing Union in their own right with their proper quota, and also as making use of another financial centre along traditional lines . . ." (V-23). But Lord Keynes admits the possibility that sterling and dollar might appear to compete with bancor for the purpose of reserve balances and suggests that "the United Kingdom and the United States might agree together that they would not accept the reserve balances of other countries in excess of normal working balances except in the case of banks definitely belonging to a Sterling Area or a Dollar Area group" (V-25).

The Agreement, too, leaves the prospective members of the International Monetary Fund free to continue their customary relationships—at least no provision to the contrary can be found in the Agreement.[37] But regionalism could hardly endanger the Fund. The Agreement would not exempt countries (belonging, say, to the Sterling Area) from provision V-6-b. Thus, if a country tied to the pound sterling increases its sterling holdings the Fund may require that part of the increase be used to repurchase part of the Fund's holdings of its currency. We should notice, furthermore, that there is no provision in the Agreement which permits the pooling of quotas for a group of countries or the transfer of quotas from one country to another.

Thus both the Agreement and the Keynes Plan are permitting (if not actually encouraging) regional groups while, at the same time, they subscribe to the principle of strictest multilateralism and exclude discriminatory practices. Is this attitude contradictory? Not necessarily. The plans can subscribe to multilateralism and, nevertheless, encourage regionalism without too much danger that the "centrifugal forces" will burst open the new payment mechanism—provided that the framework

37. The explanatory memorandum of the British experts says that section IX-3 of the Joint Statement concerning the obligation of member countries not to engage "in any discriminatory currency arrangements or multiple currency practices without the approval of the Fund" is *not* intended to interfere "with the traditional ties and other arrangements between the members of the Sterling area and London." Cf. "The Joint Currency Scheme," *The Economist*, London, April 22, 1944, p. 561.

of the new plans is strong enough and provided, above all, that the member countries join the Fund or the Union in the right spirit. While the key countries approach, too, is aimed at multilateralism, it is inferior to the new plans because it does not equip these multilateral intentions with a strong framework and does not secure them against those discriminatory practices which may easily demarcate the boundary lines between monetary blocs and can only be removed by an early concentric effort.

Whether we welcome or whether we fear economic regionalism depends on our point of view. If, in the matter of trade barriers, for instance, some countries decide to treat each other preferentially, it can mean that they want to lower existing trade barriers. But it can also mean that they want to raise their duties against outsiders. Thus regionalism can be used to achieve freer trade or to increase protectionism, to improve or to worsen international trade relations. The same holds true for monetary regionalism. Seen against the background of monetary chaos any "multilateral" agreement on a regional basis would be an advantage compared with relations of the exchange control or bilateral clearing type. But regional multilateralism would still seem insufficient when compared with a truly international monetary system. International trade must take place between the regional groups. Money earned by trading within the bloc must be able to buy in other countries unless we want international trade to shrink to a fraction of its potential size.

But once we take the principle of multilateralism for granted there is, indeed, no reason why a closer cooperation between two nations should not be welcome as a step in the right direction, which, through an additional pooling of funds and an additional effort towards exchange stabilization would actually lighten the burden which rests on the international organization. Nevertheless, we have to beware lest regionalism is introduced into the new proposals for reasons of distrust and as a kind of reinsurance. In this case the plans' liberalism in permitting the formation of blocs among the prospective members might prove to be their own undoing.

In his very stimulating paper, "The Problem of Exchange

Systems in the Postwar World," Professor H. S. Ellis discusses as one of the possible systems the case of an "exchange between blocs."[38] Professor Ellis uses quite adequately a sort of black and white technique, contrasting the dangerous with the more promising aspects of such a system of monetary blocs. First we hear that "economic medievalism would prevail in the form of exchange control, bilateral clearing and barter, discriminatory buying and selling, competitive currency depreciation and the like." But having drawn this dark picture, which reminds us of everything the new plans are against, Professor Ellis chooses brighter colors. A turn for the better is conceivable. We hear that "the existence of a few powerful units might contribute to economic stability and even expansion," that "the very inclusiveness of the unit would provide a large variety of resources within a large free trade area" and that "in the bloc situation where buyers and sellers are few, each bloc would have to take into account the consequences of its buying and selling policies upon the buying and selling policies of rival units."[39]

Thus Professor Ellis comes to the conclusion that the bloc system "affords at least certain checks to economic hostilities and offers the possibility of economic disarmament through agreement." But he does not necessarily subscribe to the key countries approach. He believes that such an evolution could only be expected "in ordinary settled times" when gradualness is appropriate. This implies, clearly, that post-war international currency stabilization should not be left to monetary blocs without the blocs being tied together by a strong multilateral framework. "The moment of the death blow to the National Socialist state," says Professor Ellis, "will be a dramatic episode, inviting a dramatic climax. The foundation of blocs would be a sorry anticlimax, for there is no escaping the animus of the bloc at its inception."[40]

38. See Papers and Proceedings, *American Economic Review,* March 1942, Supplement, pp. 195-205.
39. *Ibid.,* pp. 203-4.
40. *Ibid.,* pp. 204-5.

ADVANTAGES OF MULTILATERAL CLEARING

Money developed because barter proved to be utterly inadequate when increasing division of labor gave rise to increasing exchange. As a medium of exchange which everybody is willing to accept, money easily overcomes the difficulties of barter. The people's wishes do no longer have to coincide exactly as to the kind, quantity, and value of the things they mutually desire. We sell for money and buy for money any desired good.

This principle of indirect or multilateral exchange applies to international transactions as well as to domestic exchanges. There is no reason to assume that a country's export markets should coincide with its sources of supply. Country A may have a continuous import surplus with country B and a continuous export surplus with country C (as, for instance, Canada with the United States on the one side and with Great Britain on the other). Such a situation is absolutely normal owing to the different economic structure of the countries in question. But it requires that country A must be able to use the proceeds of her exports to country C to pay for her imports from country B. Or, stated quite generally, a country must be allowed to spend the proceeds of her exports for purchases from any other country. If a country cannot use its exports proceeds anywhere for any desired purpose the consequences are very damaging. Unable to make up for a deficit with one country by a surplus with others, a country finds its international trade equilibrium destroyed and it will try to reestablish equilibrium by methods which will drastically reduce the volume of international trade.

Mr. Folke Hilgerdt has illustrated this process of disintegration under the assumption of a rapid withdrawal of short-term capital from a country: "The currency derived from that country's export surpluses in certain directions is being transferred abroad in the liquidation of debt and thus cannot fulfill its usual function of financing import balances in other directions. The currency situation thus tightens both in the country in question and in those from which it used to derive its net imports. In such a situation it is customary to have recourse to measures of

commercial policy. But because of fear of retaliation, countries usually avoid imposing import restrictions on manufactured goods or foodstuffs from a country with which they enjoy an export surplus. If country A reduces its import balance from country B, the latter cannot retaliate but must reduce its imports from country C, with which it has an import balance, and so on."[41]

Once the countries of the world are no longer able to maintain international payment equilibrium, they will turn to bilateral agreements and other discriminatory devices, either individually or as groups. This will seem quite natural to them since each individual country will tend to blame others for a general trend from which it cannot extricate itself and which it tries to combat with policies which tend to spread the evil.

The most important and the most obvious advantage of multilateral clearing and multilateral trade is, of course, the fullest possible use which is made of the benefits of international division of labor. Any solution short of multilateralism excludes possible applications of the principle of international division of labor and is, therefore, in this respect, inferior to a multilateral system.

A system that falls short of multilateral clearing implies restrictions which are undesirable in themselves. Anything short of universality necessarily involves "the authorities in fairly close and intimate control of specific transactions. This is objectionable, in part because of the much greater apparatus of administrative supervision that is needed, with all the delay and frustration involved, but also for a more important reason. The great danger in any system of purposive direction is lest, however good the intentions may be at the outset of working for an expansion of trade and of ensuing only the common interest, it may, in fact work out to be restrictive in operation and more solicitous of sectional interests against the community than of the general good. Any system of control over foreign

41. Folke Hilgerdt, "The Case for Multilateral Trade," *American Economic Review*, March 1943, Supplement, p. 401.

trade which operates case by case, or even class by class, runs this danger which is mortal."[42]

Any system falling short of multilateralism would fail to give real economic freedom to smaller or weaker nations. Especially countries which are in need of foreign help will live in fear that "there may be political strings attached to the accommodation."[43] A pooling of funds, short-term as well as long-term, would divorce international economics from international politics and the debtor nations would be spared "the embarrassment of being beholden to any one particular creditor. They would avoid the possibility of being offered a dubious political pill in the spoonful of soothing credit syrup."[44]

Strong countries which consider themselves as "have nots" may be able to use the monopolistic and monopsonistic possibilities of their large markets through exchange control and other devices to achieve by domination what could be gained by multilateral trade. "To ascertain the functioning of the multilateral trading system is therefore not only an economic task, it is also an object of general policy, as it reduces tensions of the kind that are instrumental in bringing about war."[45]

If the Atlantic Charter wants "to further the enjoyment by all States, great or small, victor or vanquished, of access on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity," the Atlantic Charter quite obviously implies multilateral trade and multilateral clearing. In order to get the needed raw materials the countries of the world must be able to buy them and in order to be able to pay for them the countries must be able to sell on the world market. Thus nothing short of multilateral trade can fulfill this point of the Atlantic Charter.

42. "The Principles of Trade—IV: The Multilateral Approach," *The Economist*, January 22, 1944, p. 95.

43. Sidney Turk, "International Currency Plans," *Banking Sessions*, Report of the Proceedings at the Thirtieth National Foreign Trade Convention (New York, October 25, 1943), p. 34.

44. *Ibid.*, p. 35.

45. Hilgerdt, *op. cit.*, p. 405.

PLANNED MULTILATERALISM

The arguments for multilateral trade and multilateral clearing are basically sound and irrefutable. There is no substitute for multilateralism unless we subscribe to the aggressive ideas of co-prosperity sphere and *Lebensraum*.[46] If criticism is voiced within the United Nations, this criticism is not directed against the principle of multilateralism as such but rather against the methods and instruments by which multilateral trade and multilateral clearing are to be achieved.

We have already discussed the opinion of those writers who, with the aim of multilateralism clearly in mind, feel that we cannot achieve it all at once, that we must learn to walk before we try to run, and that we should tackle only one section of the world at a time.

Another and perhaps even more interesting attitude towards multilateral clearing expresses itself in the British discussion of the new currency proposals though it is unfortunate that their modern concept of planned multilateralism leads some British economists back to the bloc approach rather than to induce them to support Lord Keynes.

This British argument begins with an emphatic endorsement of multilateral clearing, multilateral trade and international division of labor. Other things remaining equal "a world-wide, multilateral system, if it can be attained is very much to be preferred to a system of barter, or of restricted bargains."[47] But these English observers are not sure that all the methods to achieve international payment equilibrium on a multilateral basis will leave "other things" equal. They are afraid of an equilibrating mechanism which would cost the participating countries more in terms of unemployment than could be gained through truly multilateral trade. Such a mechanism, we are told, was the old gold standard game, a system of inflexible exchange rates in which the deficit countries had no means of correcting

46. Even co-prosperity and *Lebensraum* philosophies might easily refuse to be satisfied before world domination is achieved. But it would be difficult in this case to distinguish the economic argument from sheer lust for power.

47. *The Economist*, January 22, 1944, p. 95.

their adverse balances except by the traditional technique of deflation with the effect of diffusing unemployment throughout the world.[48] A multilateral scheme is good only if its equilibrating mechanism is helping to create more rather than less employment. "Full employment requires," says *The Economist*, "that any limping balance of payments shall be cured by lengthening the short leg, not by shortening the long leg, and this, to judge by past experience, is most unlikely to happen in an uncontrolled system."[49] This attitude does not try to construe a conflict between multilateral trade and full employment. It only wants to show that "what full employment requires of international trade is that a country's imports and exports should *balance at a high level*."[50]

The Economist believes that this result is perfectly consistent with classical ideas. "The driving force behind the philosophy of Adam Smith and his successors was a strong belief in the natural tendencies of the economic system towards material expansion. . . . Free trade was only a means. . . . But we have learned that freedom of commerce may not be so completely synonymous with expansion, nor planning with restriction. To insist today that it is the expansion that matters most, not the exclusive use of the means securing it, is not to revolt against the liberal doctrine, but to restore it, to rescue it from the latter-day corruption which mistook the means for the end."[51]

The whole argument leads to a request for *planned expansion* and *planned multilateralism*. The gold standard mechanism secured the necessary balancing "by cutting down what is excessive."[52] The purpose of a system of planned multilateralism should be "to ensure that any balancing is secured by balancing upwards what is deficient."[53]

According to this attitude both the British and the American

48. *Financial News*, London, August 26, 1943, p. 2.
49. *The Economist*, January 22, 1944, p. 94.
50. "The Principles of Trade—III: Trade and Employment," *The Economist*, January 15, 1944, p. 65.
51. "The Principles of Trade—VIII: The New Liberalism," *The Economist*, February 19, 1944, p. 232.
52. *The Economist*, January 22, 1944, p. 95.
53. *Ibid.*

currency plans "would undoubtedly be a step in the right direction. But it would not be a very long step." [54] The main British criticism of the new plans seems to be that the plans are not expansionist enough and that their mechanisms would almost of necessity be restrictionist since almost all a deficit country can do, of its own motion, when it has exhausted its quota, is to cut down various forms of purchases. Thus, for many British observers, not even the Keynes Plan is expansionist enough, to say nothing of the much more limited quotas of the White Plan or the Agreement. At the same time these British critics know full well that a plan which would be even more expansionist than the Keynes Plan would not have even the shadow of a chance of being accepted in the United States. *The Economist* comes, therefore, to the conclusion that there is "no option but to examine the less-than-universal, the less-than-fully-multilateral, the less-than-completely-orthodox alternatives." [55]

The Economist's alternative is, we are disappointed to hear, nothing else than a system of monetary blocs. Monetary regionalism though definitely a "second best" choice is considered all we can endeavour to achieve under present conditions. We are told, however, that the blocs or regions would have to fulfill three conditions. "The first is that the accounts of each member with the other members of the grouping taken together would have to be substantially balanced, or capable of being brought into balance without undue difficulty. The second is that members of the grouping would have to give assurance that they would cooperate in removing any disequilibria that might appear by increasing their trade. . . . The third is that members would have to give satisfactory assurances that they would, within their borders, avoid large-scale depressions." If these conditions would be observed, continues *The Economist*, "a grouping of this nature would provide a working model of the principles of trade expansion which it would be hoped to extend, when conditions permitted, to the whole world." [56]

54. *Ibid.*

55. "The Principles of Trade—V: Planned Expansion," *The Economist*, January 29, 1944, p. 137.

56. "Principles of Trade—VI: "The Regional Solution," *The Economist*, February 5, 1944, p. 170.

Our critique of the expansionist philosophy of the Keynes Plan need not be repeated.[57] If the Keynes Plan might prove too expansionist and too inflationist, what about a system of planned multilateral groupings which is designed to overcome the "restrictionist" and "deflationist" features of the Keynes Plan even at the price of giving up the admitted advantages of full-fledged, world-wide multilateralism? If the gold standard mechanism was too deflationist, this new system of monetary blocs, whose expansionist intentions would dwarf those of the Keynes Plan, would certainly be exposed to the mortal danger of over-expansion. Why does *The Economist* completely ignore the results of modern business cycle research? How can the members of a group give satisfactory assurances that they will, within their borders, avoid large-scale depressions if the expansionist bias of the whole scheme endangers economic stability just about as much as did the contractionist bias of the gold standard system?

If the accounts of each member of the grouping with the other members taken together would have to be substantially balanced, this condition could only be fulfilled at the expense of giving up real, world-wide multilateralism. In the attempt to achieve the desired multilateral clearing *within a given area* the grouping would inadvertently surround itself with a fence of discriminatory devices and it is difficult to see how countries outside the group could possibly interpret such a fence as a sign of friendly collaboration or as construction of a path towards true multilateralism.

The Economist believes that "in theory, three possible systems of international trade can be set up—the wholly uncontrolled; the planned expansionism . . . ; and the narrow restrictionism of two sided barter"; and adds, warningly, that "those who reject the middle solution, hoping to get the first, are far more likely to find themselves saddled with the third."[58] We could find ourselves in close agreement with *The Economist* if the middle solution could be identified with the basic ideas of the Agreement. Unfortunately we have to come to the conclusion

57. See Chapter IX, *passim*.
58. *The Economist*, February 19, 1944, p. 233.

that the regionalism which seems to *The Economist* to be preferable to the Keynes Plan might finally degenerate into a restrictionism much more narrow and dangerous than *The Economist* anticipates. Regionalism and true, world-wide multilateralism are incompatible by definition provided that the region is supposed to become a self-contained clearing unit whose members are not, at the same time, members of a real multilateral clearing system. It sounds very much like quibbling and self-deception when *The Economist* suddenly distinguishes *multilateral* from completely *universal* trade and when it sets the *regional* solution as "*multilateral solution in the narrower definition of the word*" against the universal or *omnilateral* solution.[59]

In his speech before the house of Lords of May 23, 1944, Lord Keynes criticized this attitude rather sharply. Again he emphasized the necessity of inter-convertibility of national currencies. And then he added: "To suppose that a system of bilateral and barter agreements, with no one who owns sterling knowing just what he can do with it—to suppose that this is the best way of encouraging the Dominions to center their financial system on London, seems to me pretty near frenzy. As a technique of little Englandism, adopted as a last resort when all else has failed us, with this small country driven to autarchy, keeping itself to itself in a harsh and unfriendly world, it might make more sense. But those who talk this way, on the expectation that the rest of the Commonwealth will throw in their lot on these lines and cut their free commercial relations with the rest of the world, can have very little idea how this Empire has grown or by what means it can be sustained."

59. *Ibid.*, February 5, 1944, p. 70.

XIII

THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PURPOSES OF THE BANK

THE International Monetary Fund is not intended to provide facilities for reconstruction and development. Even though the Fund can be considered as an international "credit pool" it furnishes only short-term credit facilities in international money to enable a member to bridge temporary disequilibria in its balance of payments. The Fund must under no condition let the buying rights of the members degenerate into long-term "loans." The use for investment purposes of the reserves of international money provided by the Fund would violate the very character of the Fund by making it completely illiquid.

On the other hand, it is quite obvious that many members of the Fund will need long-term foreign loans for reconstruction and development so badly that they might be tempted to spend their reserves of international money for investment purposes unless long-term capital is made available to them on reasonable terms. The creation of an International Bank for Reconstruction and Development would, therefore, protect the Fund against misuse of its resources just as the Fund would establish a sound foundation for international capital movements through multilateral clearing, the gradual elimination of exchange restrictions and the maintenance of orderly exchange rates.

The International Bank for Reconstruction and Development, as agreed upon in Bretton Woods,[1] has the purpose of facilitating and promoting foreign investment. Domestic loans are excluded from the activities of the Bank; the loans made, par-

1. See Chapter I, p. 5; Chapter IV, p. 48; and Appendix V.

ticipated in, or guaranteed by the Bank are international long-term loans, i.e., loans whose creditors and debtors reside in different member countries.

For a clear understanding of the operations of the Bank the following points must be kept in mind:

(1) Foreign loans add to the productive resources available to the borrowing country while domestic loans imply only a change of hands of loanable funds within a country.

(2) On the other hand, the servicing of a foreign loan (the payment of interest and amortization), means a real burden for the debtor country while what is paid on a domestic loan is received by residents of that country.

(3) Foreign loans and the servicing of foreign loans affect the balances of payments and the rates of exchange of debtor and creditor countries.

(4) Payments of interest and amortization on foreign loans are, therefore, not merely a problem of how to raise enough domestic currency. The money has to be transferred into the currency of the creditor country. This transfer can only be accomplished by an excess of exports over imports in the paying country and by an excess of imports over exports in the receiving country.

(5) International loans and investments should, therefore, be made only in total amounts and in a manner which, later on, will permit the transfer of the service payments through an export surplus. But this does not mean to say that international loans could be given only to export industries.

(6) This implies that the creditor country should, from the very beginning, be completely conscious of the fact that it shall have to receive in the future payments in the form of an import surplus and that to refuse to accept these payments through cumulative protectionism would be more dangerous than the refusal to lend in the first place.

(7) Foreign loans are safe only if their total amount bears a reasonable proportion to the debtor country's ability to meet the service requirements and if the conditions of each individual loan (rate of interest, period of amortization) fit the character of the investment project.

(8) International loans should not lead to bilateralism. "Tied loans," loans which have to be spent in the creditor country, are to be avoided and no political strings of any sort should endanger the debtor or creditor. Money borrowed in any one country must be able to buy in any other (member) country, just as the collection of debts must be free from exchange restrictions.

These principles of sound international investment were not heeded during the inter-war period. Foreign funds were borrowed for purposes of dubious productivity, sometimes at exorbitant risk premiums. The transfer problem was equally ignored in the borrowing and in the lending countries and the latter excluded, through increasing tariffs, the very payments on which they insisted. Short-term credits were used for long-term investments and reparations were transferred through the medium of commercial credits. The whole international credit system disintegrated finally causing deflation, unemployment, increasing protectionism, and exchange control.

It would be unfair to criticize, ex post facto, private borrowers and private creditors too much for these events. But we have to admit as a fact that private finance was not able to solve the problems of post-war international lending. Reference to the superior wisdom of the private investor would, therefore, be a poor argument against the proposed International Bank, an argument for people with short memories and an indefatigable confidence in the magic of the profit motive.[2]

2. See, e.g., the editorial, "An International Bank," *New York Times*, July 19, 1944: "Under a free world economy, with private lenders risking their own funds and borrowers seeking to meet their requirements, loans would go to the countries and projects that offered the most attractive terms commensurate with the best prospect of repayment. This means, in general, that capital would go into the countries providing the soundest conditions and into projects promising the greatest economic success." Did this happen after the last war? Of course, it can be pointed out that cumulative protectionism and exchange control did not provide the conditions of a "free world economy." But can we hope for the fulfillment of these conditions unless we create international institutions which try to avoid the mistakes of the past? Moreover, let us not forget that cumulative protectionism had its roots in the same profit motive which, in other respects, is so blindly trusted.

This does not, of course, imply that the new bank is to take the place of the private investor. Far from it: the Bank has the purpose "to promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources" (I-ii).[3]

Whether private capital is available or not will partly depend on the conditions of the loan contract. At very high premiums "risk capital" may be available; or it may be available only in the dangerous short-term form when it is obvious that it will be used for long-term investment purposes.

Inter-war experiences prove that the flow of "risk capital" is not always desirable. Where exorbitant rates of interest (or, better, risk premiums) direct the flow of international capital we cannot be sure that the available funds are invested according to the marginal efficiency of the projects concerned or according to their importance for the productivity of the economy as a whole. Those who are willing to borrow at extremely high rates and other unfavorable conditions, and those who are willing to lend at usurious rates, are not necessarily the most reliable judges as to how a limited amount of international loanable funds should be allocated. An institution which can survey the financial and the international trade situation of a borrowing country in its entirety, and in comparison with the situation in other countries, will be able to help steer the flow of loanable funds in the right directions. It is, therefore, one of the purposes of the Bank "to arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first" (I-iv).

This is of particular importance during the transition period when private capital will be reluctant to venture abroad on reasonable terms. The transition period will be a time of urgent

3. The Articles and Sections quoted in this chapter refer to the Bank Agreement, not to the Fund Agreement.

need for foreign long-term capital for reconstruction and reconversion. Like the Fund, the Bank will be of inestimable value "in bringing about a smooth transition from a wartime to a peacetime economy" (I-v).

STRUCTURE AND OPERATIONS OF THE BANK

The authorized capital of the Bank will be ten billion dollars.[4] The members subscribe shares of the capital stock of the Bank (II-3). These subscriptions are, in several respects, similar to the quotas of the Fund.[5] They determine the relative share of a member in the management of the Bank (V-3) and they limit, of course, the members' obligations (II-6). But they do *not,* like the quotas of the Fund, limit the amount of loans or guarantees of loans which a member can arrange with the Bank.

The Bank's main function is to act as a guarantor of private loans placed through the normal investment channels (I-ii; III-4; IV-1-a-iii; IV-5). For this function no funds are required until, in case of default, the Bank has to meet contractual payments of interest and amortization on guaranteed loans. Hence it is sufficient that the Bank should have the right to call in the necessary amounts when needed (II-5-ii). Eighty per cent of the subscribed capital is, therefore, not to be paid in by the members. It is a surety fund which is protected, moreover, by a "special reserve" and other resources of the Bank against which liabilities of the Bank on borrowings and guarantees have to be charged first (IV-7-b), i.e., before the Bank may call it an appropriate part of the unpaid subscriptions of the members (IV-7-c). These payments, if any, would have to be made, at the option of the members "either in gold, in United States dollars or in the currency required to discharge the obli-

4. Of which 9.1 billion dollars have so far been allocated to prospective members. See Art. II-2 and Schedule A.

5. The similarity of the Fund-quotas and the Bank-subscriptions is obviously due to the fact that both are based on formulae which contain as determining factors the national income of a member, indicating its importance, and the volume of its foreign trade, indicating the general interest of a member in an institution which wants "to promote the long-range balanced growth of international trade" (I-iii).

gations of the Bank for the purpose for which the call is made" (II-7-ii).

Twenty per cent of the subscribed capital will be paid (II-5-i): two per cent in gold or United States dollars and the remainder in the currency of the member (II-7-i). This is the "working capital" of the Bank, available for loans and the participation in loans. But the Bank's ability to make loans is not limited to this fund of less than two billion dollars. Besides being a guarantor and a direct lender of its own funds the Bank can act as an intermediary. The Bank may, with the approval of a member, sell its own securities in the member's market and use the loanable funds thus acquired to make or participate in loans (IV-1-a-ii; IV-1-b).

But all activities of the Bank, taken together, are strictly limited. "The total amount outstanding of guarantees, participations in loans and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed one hundred per cent of the unimpaired subscribed capital, reserves and surplus of the Bank" (III-3).[6]

We see that the right to issue its own securities would not enable the Bank to increase its total liabilities. It would mean only that the Bank can shift its emphasis from guarantor to intermediary if this should be considered desirable. Since the Bank can sell securities in which it has invested, can guarantee securities which it sells and buy guaranteed securities (IV-8), it can shift its activities within the prescribed limit as general conditions may require.

Like the Fund, the Bank deals with its members only through their Central Banks, Treasuries or other fiscal agencies (III-2). But the Bank can guarantee, participate in or make loans to not only members and their political subdivisions but also to "any business, industrial, and agricultural enterprise in the territories of a member" (III-4).

6. *The Economist* interprets this section to mean that the Bank can guarantee very large sums "since the guarantee will relate only to interest and service." This is quite obviously a misinterpretation. Once a loan goes bad the Bank is liable for all of it and not only for one year's service. See "Bretton Woods," *The Economist,* July 29, 1944, p. 139.

But all guarantees and loans are subject to the following conditions (III-4):

(i) "When the member in whose territories the project is located is not itself the borrower, the member or the central bank or some comparable agency of the member which is acceptable to the bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan."

(ii) "The Bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower."

(iii) "A competent committee (appointed by the Bank according to Art. V-7) has submitted a written report recommending the project after a careful study of the merits of the proposal."

(iv) "In the opinion of the Bank the rate of interest and other charges are reasonable and such rate, charges and the schedule for repayment of principal are appropriate to the project."

(v) "In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole."

(vi) "In guaranteeing a loan made by other investors, the Bank receives suitable compensation for its risk."

(vii) "Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development."

These conditions are certainly aiming in the right direction. That some formulations are rather vague (e.g., the concept of "development" or the criteria of the "merits of the proposal") cannot be helped. The member's guarantee is, at any rate, a valuable second line of defense and a committee of neutral experts will be a better judge for the type of loans the Bank will guarantee or make just because it will be independent of personal financial interests.

More problematic are perhaps conditions (ii) and (iv), since it may well be asked, "How many loans are there likely to be which are safe enough to meet the Bank's standards and yet

not safe enough to float on their own merits?"[7] Only practical experience will answer this question. During the transition period the Bank will, undoubtedly, have a broad field for its activities since it is most unlikely that private capital will be available in sufficient amounts and on reasonable terms. If, later on, the Bank's activities should become more and more limited because private capital would gradually take over under equally favorable conditions for the borrower, the purpose of the Bank would be fulfilled. It is quite possible that the mere presence of a source of international credit at reasonable rates for sound purposes would keep rates down even if the actual demand for guarantees or loans from the Bank were not large.

Moreover, the Bank may possibly find a useful field in the extension of guarantees or loans of smaller amounts which private capital may easily neglect. This problem, not unknown in domestic banking, lends itself particularly to a solution by an institution which is willing to serve as a guarantor or to issue its own securities in lieu of smaller borrowers.

Private investment depends on profit anticipations. Profit anticipations fluctuate with the business cycle. During periods of depression private capital may not be available without the guarantee of the Bank. The Bank's activities may, therefore, increase when private investment tends to fall off, thus causing a beneficial countercycle effect which could contribute considerably towards more stable employment conditions throughout the world. Where the guarantee of the Bank would not suffice the Bank could issue its own obligations to secure loanable funds for investment projects which, though in the eye of the private investor at the moment not profitable or secure enough, would nevertheless help to maintain a given employment and income level. The Bank could, in other words, act as a counterweight to the swings of private international investment, similar to the compensatory spending of governments when expenditures are shifted as far as possible from time of prosperity into time of depression.

7. *The Economist*, July 29, 1944, p. 139.

MULTILATERALISM

As a companion agency to the Fund, the Bank is based entirely and unequivocally on the multilateral principle. Art. III-5 provides that "the Bank shall impose no conditions that the proceeds of a loan shall be spent in the territories of any particular member or members." The Bank may borrow funds and guarantee loans only if the member in whose markets the funds are raised or in whose currency the loan is denominated agree "that the proceeds may be exchanged for the currency of any other member without restriction" (IV-1-b). In other words, the money borrowed can be spent in any member country. Thus the Bank enables its members to borrow in the most favorable capital market and to spend the borrowed funds wherever raw materials, machines, etc., should be bought according to strictly economical considerations. No political or economic strings will be attached to loans which the Bank guarantees, participates in or makes (IV-10). Thus bilateralism is prevented and it is to be hoped that, under the competitive influence of the Bank, private investors will find it impossible to impose conditions on borrowers which would violate the principle of multilateralism. The borrower, on the other hand, will not be able to use payment difficulties via exchange control to force the creditor into bilateral deals. Each member guarantees payments on loans for projects in its territory and by refusing to fulfill its obligations to the Bank it would antagonize all other members—a policy which it would hardly find advisable.

Of course it can happen that a member finds itself unable to live up to its promises. In case of "acute exchange stringency" a member may apply to the Bank for a relaxation of the conditions of payment (IV-4-c). If the Bank is satisfied that some relaxation is in the interest of the member, the other members or the Bank, it can do two things: (1) it can accept service payments in the currency of the member for periods not to exceed three years and arrange for the repurchase of such currency on appropriate terms; and (2) it can modify the terms of amortization or extend the life of the loan, or both (IV-4-c).

Where the Bank has only given its guarantee these relaxa-

tions, which concern direct loans, are not applicable. But the Bank has the right to terminate its liability to the creditor of a guaranteed loan by offering to purchase the loan at par and interest accrued (IV-5-c) after which purchase the above mentioned relaxations could be arranged.

When the Bank makes loans or participates in loans it must be able to supply the borrower with currencies of any member from which the borrower wants to buy. The Bank is able to do so because its resources consist of currencies of all members or of gold and United States dollars. Gold has, as in the Fund, the function of a transformer which increases the liquidity of the Bank's resources. That the dollar is considered equivalent to gold is easily explained by the position of the United States as the main creditor nation among the members.

The Bank's foreign exchange resources will, under certain conditions, be available to a member in whose territories part of the loan is spent. This member's demand for imports may increase because of its exports (e.g., when more raw materials have to be bought) and the Bank is, therefore, willing to repurchase with gold or foreign exchange a part of that member's currency which was spent by the borrower (IV-3-d).

In one respect only the Bank seems to fall short of a complete application of strictest multilateralism: it is, as a rule, not willing to provide the borrowing member with the member's own local currency (IV-3-a). In other words, the Bank does not arrange domestic loans. This seems quite obvious since a country can, of course, supply its own domestic money. But the following consideration is in order.

Many borrowers want, first of all, domestic money. If they borrow abroad they will sell the borrowed foreign funds on the domestic exchange market for local currency to importers who, then, import whatever commodities can be bought more cheaply abroad than at home. Of course, the character of the imported commodities would, under these conditions, have nothing whatsoever to do with the project for which the foreign debt was incurred and we should try in vain to gauge the productivity of the project or projects by the character of the country's imports. Foreign lending and foreign trade would be com-

pletely disconnected as far as each individual loan is concerned. Borrowing and buying would follow the laws of their respective markets, and only indirectly and on the whole would creditor and debtor countries find their international trade balances adjusted to changes in their credit balances.

But to be an ideal solution this case would require ideal conditions which may not be fulfilled. A country with great scarcity of capital may all too easily be tempted to accumulate a transfer burden far beyond its strength. Moreover, the country may borrow abroad what it could have created at home. A scarcity of capital may be caused by an insufficient supply of savings owing to a low national income and unemployment. This situation can, at least partly, be overcome by credit creation. In this case a country should try, first of all, to mobilize its own resources instead of relying too much on foreign help. To borrow abroad what could be extracted from the country's own unused resources would be foolish. Only such additional help should come from the outside as is complementary to and indispensable for full employment at home.

It is, therefore, commendable that the Bank should, on principle, refrain from loaning for purposes other than those which require imports from abroad. Article III-5-b provides that the Bank "shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted. . . ." That the Bank is normally not supposed to provide local funds which could be borrowed in a member's own capital market, is implied in Article IV-3-b according to which the Bank may, *in exceptional circumstances*, when local currency required for the purpose of the loan cannot be raised by the borrower on reasonable terms, provide the borrower, as part of the loan, with an appropriate amount of local currency.

SPREADING THE RISK

Professor Williams' only remark concerning the Bank proposal implies an interesting criticism. "I have not been able to see," he writes,[8] "how such a bank can be international, except

8. "The Postwar Monetary Plans," *American Economic Review*, March, 1944, Supplement, p. 372.

in a formal or limited sense, in a world containing only one large creditor and many debtors." In other words, the United States cannot escape the creditor's risk, the weak cannot protect the strong, and to have loans guaranteed by the debtor against default does not make them any better. For "who is to guarantee the guarantors?" [9]

To answer this argument we shall have to find out in which respect the Bank can, through international organization, achieve a greater amount of financial security than could otherwise be obtained. This will answer the question whether the international character of the Bank is purely formal or not.

For the creditor countries the Bank reduces the risk connected with foreign loans by spreading losses proportionately according to the members' subscriptions (II-7-iii). This advantage can be ignored only when one assumes that all the debtor countries among the members would find themselves simultaneously in a completely illiquid condition, unable to meet their international financial obligations. This would imply that not only the borrowers themselves fail to pay or to transfer their payments, but also that the members' double guarantee—as guarantors for the projects in their territories and as subscribers of the Bank's unpaid capital—is worthless. Only under the assumption of a world-wide credit crisis of very great proportions could such pessimism be justified. But the Bank is expressly designed for the prevention of developments similar to those which, in the early thirties, led to the breakdown of the international credit structure.

The Bank's main purpose is not the distribution of losses but the prevention of losses. First, the Bank sees to it that each individual loan which it makes, participates in, or guarantees is basically sound and fit to strengthen the member's productivity and, therefore, indirectly, its export position; secondly, it tries to arrange its loans and guarantees in such a manner "that the more useful and urgent projects, large and small alike, will be dealt with first" (I-iv). Acting on these principles, the Bank would achieve a diversification of risk which would probably be superior to that of institutions of smaller scope. Because

9. *New York Times*, July 19, 1944.

the Bank is not only international but world-wide in its activities, and in its information, it should be able to allocate its funds or the funds guaranteed by it in a well-balanced, prudent way and to keep its members continuously aware of their inescapable interdependence and of their mutual obligations as debtors and as creditors.

Seen in this light, it can hardly be maintained that the Bank would be international only in a formal or limited sense.

PROTECTION OF MEMBERS

The detailed provisions of Articles IV and V concerning the Bank's operations, organization and management will not be discussed. They are, in many respects, similar to those of the International Monetary Fund. Only the provisions which serve to protect the members against unwelcome effects of the Bank's transactions upon their economies will briefly be mentioned.

Both the foreign exchange and the credit market of a member might be adversely influenced by the Bank's operations.

As far as a member's security market is concerned, the member must, of course, remain sole judge whether it wants to make its funds available to the Bank. And since all transactions with the Bank would take place through the Central Bank or the Treasury of the member, there is hardly a transaction conceivable which would, via a change in the commercial banks' reserve deposits, not tend to influence the member's money market.[10]

It is, therefore, natural that the Bank will only be able to raise funds in a member's market with the approval of the member (IV-1-b) and that currencies paid into the Bank "shall be loaned

10. The International Bank holds its resources of a member's local currency in the member's Central Bank (V-11). As the local currency is made available to and spent by a borrower, the local currency is received by domestic firms and deposited in commercial banks. The commercial banks in turn deposit the money with their Central Bank thus increasing their reserves by the same amount by which their demand deposits are increased. And since only a fractional reserve is required, the commercial banks are, *ceteris paribus*, in a position to expand their loans by an amount several times larger than the original loan by the International Bank.

only with the approval in each case of the member whose currency is involved. . . ." (IV-2).

The foreign exchange markets of the members are protected against unfavorable effects due to action by the Bank as far as this is possible without violation of the basic principle of multilateralism. The discussion of the operations of the International Monetary Fund in Chapter VI has shown that international long-term investment will, as a rule, stabilize rather than unstabilize the members' balances of payments. We saw that a surplus country may easily avoid the rationing of its currency by increased foreign investment or by loans to the Fund. Situations are conceivable, however, where a loan would tend to disturb, temporarily, the balance of payments of a creditor or a debtor country. The creditor country may, e.g., find that its exports do not increase sufficiently to correspond to its foreign investments or the member in whose market the loan is spent may find its imports for raw materials and, therefore, its demand for foreign exchange increased. Similarly, the debtor country may, under the influence of a foreign loan, expand or readjust its economic activities in a manner which could lead to a demand for foreign exchange in addition to the funds made available by the loan.

The Bank will be able to help adjust these occasional difficulties (IV-3) and can also rely on the fullest cooperation of the Fund.

BUILT ON SAND?

But what about the time when the loans are to be paid back? Harold Fleming[11] believes that, while the Bank is designed as well as could be asked and while it should make possible more and better loans, and in a more orderly fashion, it is, nevertheless, built on sand. The serious weakness in the foundations under the Bank's well-built structure, he argues, is that it helps its members to get into debt with the United States, a country which does not want their goods. Thus the Bank only helps to avoid balance of payments difficulties today by rolling up trouble for the future.

11. *Christian Science Monitor*, August 15, 1944.

The same problem worries *The Economist*.[12] Commenting on the Bretton Woods Agreements the paper comes to the conclusion that the success of both the Fund and the Bank rests on assumptions whose fulfillment is perhaps not impossible, but not very probable either.

The world in which alone the Fund and the Bank could really work "would be one in which at least the major countries were successful in avoiding unemployment crises, in which there was a substantial lowering of tariffs and other trade barriers, in which creditors behaved as creditors should, in which debtors did not default—in short, in which balances of payments were naturally brought into equilibrium by expansion, not forced into it by contraction."[13]

True, a repetition of the mistakes of the thirties in employment and foreign trade policies could jeopardize the success of the proposed monetary and financial institutions. But should we really be so obsessed by fear? Of course, the monetary and financial agreements will have to be followed by a similar agreement concerning foreign trade policies.[14] The success of Bretton Woods justifies hopes that such an agreement can be achieved. And if international relations are put on a sound basis we may also hope that the problem of full employment will be more successfully handled than during the inter-war period.

This reasoning does not indulge in unwarranted optimistic predictions. It says only that the success of the Fund and the Bank should not be endangered by the fear of events which it is in our power to prevent.

And can it really be argued that foreign loans in general are no longer advisable because they would lead to difficulties much worse than those which they help to mitigate? Even if we admit that the new institutions might be gravely endangered through a possible failure of the members to live up to the standards of behavior which an orderly world trade requires, is

12. "Bretton Woods," *The Economist*, July 29, 1944, p. 139.
13. *Ibid.*, p. 139.
14. See, e.g., *World Trade and Employment*, The Committee on International Economic Policy (New York, June 28, 1944).

this reason enough to plunge the world prematurely and perhaps unnecessarily into the difficulties which might follow a thoroughly uncertain breakdown of the new international system?

A series of well-integrated international agreements of the Bretton Woods type have the very purpose to avoid the disaster in which they could go under.

That the United States will forever refuse to import more than she exports, that she will never learn to behave as a creditor, is an unwarranted assumption. The service payments on long-term international loans will be made in an orderly manner, will be spread over a reasonable period of time, and will take place under conditions of multilateral clearing and an expanding world economy. Nor should it always be forgotten that a creditor, in enjoying additional imports, does not have to take away purchasing power from the domestic market since he can buy in foreign markets with the money owed to him.

XIV
CONCLUSION

A SUCCESSFUL COMPROMISE

THE United Nations Monetary and Financial Conference at Bretton Woods was a success because the representatives of forty-four nations had the wisdom to modify their individual and national preferences and to agree on a world-wide system of monetary and financial cooperation. Cooperation and multilateral clearing can be achieved only when a great majority of nations believe that the proposed system is to their advantage and this great majority can be won only if extreme positions, not acceptable to some of the prospective members, are sufficiently revised. A country cannot insist on its own brand of multilateral clearing because it needs the willingness of other countries to desist from discriminatory policies; and desist they will only if the price for multilateralism is not considered worse than bilateralism.

Different countries have different monetary interests: the capitalist economies face problems to which a planned economy can be indifferent; debtor and creditor countries have often conflicting viewpoints; gold holdings and gold production create a preference for the monetary use of gold while others fear the strait-jacket of gold; exchange control seems quite indispensable to one country and particularly obnoxious to the next; and cheap money policies at home are to some countries preferable to stable exchange rates.

To achieve a workable compromise between these different viewpoints and diverging interests is not easy. To achieve it through a combination of the constructive features of compet-

ing proposals means success. The compromise solution of Bretton Woods creates a framework for international monetary and financial cooperation which is strong and flexible while offering to the weaker members the help without which they could not join the stronger nations in a genuinely multilateral organization.

To achieve a similarly broad agreement any alternative plan would have to be so nearly identical with the present proposals that it would be inexcusable to reject the results of Bretton Woods on account of minor points. A plan which would deviate considerably from the proposed compromise now awaiting final endorsement would have no chance of being adopted by a majority of countries and could not, therefore, lead to a multilateral solution.

The failure of the present endeavors could easily be tantamount to the breaking apart of the world into monetary blocs which would again embark on discriminatory policies. This would foreshadow a new wave of economic nationalism. It would, in fact, be its beginning. And the peace might be lost before the war is won.

The very nature of a compromise implies that nobody is fully satisfied. In the United States, for instance, we could perhaps be tempted to reject the Fund because of the possible rationing of dollars as a scarce currency. Exchange control, we could argue, is bad and conflicts with multilateral clearing. This seems convincing enough. But it is wrong because by refusing to join a system which is tainted with exchange control we are not creating a system which is free from it. We only destroy our last chance of getting a multilateral payment system and consequently will soon be enmeshed in controls and discriminations which are much worse.

Our approach must be different. If it is not desirable that the dollar should be subject to exchange control, we must try to avoid situations in which the Fund would be forced to apportion its dollar resources. Adequate policies in the debtor and creditor countries may restore equilibrium before a currency becomes scarce; credits will help; appreciation of the scarce currency can be considered. Indeed, impending exchange con-

trol may have the beneficial effect of impressing on the creditor the necessity of adequate action.

A QUESTION OF ALTERNATIVES

Assuming that the Bretton Woods Agreements may not be ratified, is there any other proposal, aimed at multilateral clearing, so definitely, so obviously superior that it would be accepted by a majority of nations in the atmosphere of disappointment, pessimism, and cynicism following a refusal of the respective governments to endorse the proposed institutions?

The key-countries approach is perhaps the next best proposal. Unfortunately it amounts to the Fabian advice not to undertake the difficult task of international currency stabilization right now, to proceed more cautiously and to wait first for greater domestic stability in the prospective member countries. Thus it leaves the weaker countries, right after the war when they are most in need, without the help which the proposed monetary and financial institutions could render. Left alone the deficit countries are liable to employ measures destructive of international prosperity. They will either try to increase their exports through competitive exchange depreciation or they will cut down imports through cumulative protectionism and exchange control. Domestic stability, for which the key-countries approach is waiting, may be achieved, if at all, at the expense of international cooperation. The key-countries approach is dangerous because it refuses to forge a durable and comprehensive international framework before it is too late.

The gold standard mechanism is a multilateral solution of considerable prestige. Nevertheless, it cannot compete with the Fund as a practical post-war solution because it is unacceptable to a number of countries, including Great Britain. This fact could not be ignored, even if the merits of the gold standard were much more obvious than they actually are and even if a more equal gold distribution could be achieved. The friends of gold request rigid exchange rates, strictest elimination of exchange control and reciprocal deflation and inflation according to gold movements; they also insist on very conservative

domestic policies with balanced budgets and without government deficit spending.

British experts, on the other hand, consider these conservative recipes as the surest way to unemployment, first in the deficit countries, and then in the whole world. Rather than being tied to gold they would do without a multilateral solution. Some, not even willing to accept the Keynes Plan, propose, therefore, a less than multilateral solution which would amount to the creation of monetary blocs.

If we take the Keynes Plan as typical for Great Britain's first choice, we can easily see why such a plan, in turn, would not be acceptable to the creditor countries.

The creditor countries cannot be expected to endorse a plan for the creation of international bank money according to which the debtor countries might control the credit expansion in the creditor countries. The creditor countries insist on a right to their own domestic policies just as much as the deficit countries. As the latter refuse to adopt the gold standard to avoid deflation, so creditor countries insist on a sufficient modification of the Keynesian proposal to protect themselves against inflation.

Thus we see that no alternative to the Bretton Woods Agreements is equally acceptable to all prospective members of an international system: the road to international monetary cooperation has to lead through and not around Bretton Woods.

A CONSTRUCTIVE SOLUTION

How does the international Monetary Fund reconcile these diverging interests and theories?

(1) The Fund puts adequate reserves of "international money" in the form of buying rights at the disposal of the members. Thus one of the most urgent economic post-war problems is solved without necessitating a redistribution of gold for which, incidentally, so far no adequate suggestion has been made. The availability of sufficient reserves of international money is of paramount importance; it prevents prospective deficit countries from "resorting to measures destructive of national or international prosperity."

(2) The Fund sees to it that the members do not lose their reserves in the vain attempt of trying to hold untenable positions. Prolonged deviations from international payment equilibrium are not permitted. But the responsibility is not one-sidedly fixed on the deficit countries. Both deficit and surplus countries are induced to follow policies which tend to maintain international payment equilibrium.

(3) The Fund does not interfere, however, with the members' domestic policies. This is already implied in the fact that the members have different social-economic systems. If completely planned economies like Russia on the one side and capitalist economies like the United States on the other are members, how could the Fund discriminate against their social and political policies? Moreover, it has to be taken for granted that full employment policies will rank higher than fixed exchange rates in the scale of preferences of many members.

(4) The Fund has the purpose to promote exchange stability but it does not insist on rigid parities. If a member's domestic policies lead to a national price level which is at variance with the established parity, the resulting international payment disequilibrium is considered "fundamental," and the member will be given the right to adjust the par value of its currency accordingly. Depreciation is generally considered more advisable than deflation.

(5) While the Fund permits changes in the par values of the members' currencies, it makes these changes dependent on the approval of the Fund and excludes, therefore, unilateral and competitive exchange depreciation.

(6) Orderly exchange depreciation is not only necessary for the protection of deficit countries against deflation; it also protects the surplus countries against inflation. Credit expansion in deficit country *plus* exchange stability would force the surplus countries into foreign lending or into domestic credit expansion. Only depreciation of deficit currencies or appreciation of surplus currencies can insulate the members against undesired effects of the domestic policies of other members.

(7) The obligations of the prospective creditor countries as members of the Fund are strictly limited. In contradistinction

to the Keynesian Clearing Union, the Fund does not create international bank money. The members have no overdraft privileges but they can buy, within limits, foreign exchange from the Fund. Since the aggregate buying rights of the prospective deficit countries may be larger than the Fund's supply of currencies of surplus countries (plus gold), rationing of scarce currencies must be provided for. But the creditor countries can protect themselves against this unpleasant eventuality through loans to the Fund or to other members and through appreciation of their currencies.

(8) The Fund *tends* to eliminate exchange control as incompatible with multilateral clearing. But it permits its members to maintain and to adapt to changing circumstances restrictions on payments and transfers for current international transactions during the transition period. Exchange controls, furthermore, cannot be dispensed with as a weapon against capital flight movements.

(9) The Fund uses gold as a common denominator for the member currencies and as an asset of highest international liquidity. It also establishes a firm market for gold. But the operations of the Fund are not a replica of the gold flow mechanism nor are the members "tied" to gold. They merely express the par value of their currencies in terms of gold and promise not to change this par value without authorization by the Fund.

(10) The Fund attempts to achieve the maximum amount of integration of the credit policies of the members which is attainable without coercion. It makes, therefore, an effort towards exchange stability which is, theoretically, superior to the blind forces of the gold mechanism. If the Fund should succeed in this ambitious endeavor, it would resolve most of the difficulties which endanger an international monetary system in the modern world.

DANGER POINTS

Purists may point out that the Fund Agreement is full of inconsistencies. Non-interference seems incompatible with an equilibrating mechanism, exchange stability with depreciation, exchange control with multilateral clearing. These criticisms

ignore the compromise character of the Fund. But they indicate, nevertheless, the conflicts and tensions which will tax the strength of the Fund's structure and the members' willingness to cooperate. The Fund itself is only an instrument whose quality will depend largely on the policies which it will be made to serve.

Some of the concepts used in the Fund Agreement are of necessity rather vague, some of the provisions are difficult to interpret. What, precisely, is a "fundamental" disequilibrium? How important an aim is the promotion of exchange stability? If, for instance, a member's social and political policies cause a fundamental disequilibrium, has the member violated the purpose of the Fund which is exchange stability? Is the member, then, ineligible to use the resources of the Fund?

What, precisely, are current transactions? How can exchange controls be exercised in a manner which will not restrict payments for current transactions? How can allocations and controls of scarce currencies be prevented from leading into bilateral clearing arrangements and other discriminatory practices?

How are exchange rates to be determined? When are depreciations to be granted by the Executive Directors, considering the complexity of the problem and the understandable jealousies of the members? And how can overexpansion and inflation be avoided when contraction and deflation seem to be *a priori* excluded?

These are pertinent questions. They mark difficult problems for the Board of Governors, the Executive Directors and the monetary authorities of the members. It will take many years to work out the proper techniques and policies of international monetary cooperation.

The broad and often intentionally vague formulations of the Fund Agreement will have to be interpreted and the Fund's mechanism operated in a spirit of mutual understanding born of the painful experiences of the years between the wars. The new system will, no doubt, have to pass through crises when its survival alone will be an achievement. But as more peaceful times are reached and as the members learn to stabilize their

own economies, we can gradually develop the art of integrating the monetary policies of the member nations just as a Central Bank integrates the policies of its member banks.

The Fund will be a place where the diverging national interests and conflicting theoretical viewpoints can be continuously discussed and compromised. Its members will remain conscious of their mutual interdependence and will be willing to cooperate rather than to face the consequences of another period of monetary chaos.

The Fund is the only practicable multilateral solution of the world's monetary problems. To fail to back up the Fund proposal means to risk destruction of the last chance for a return to healthy multilateral trade. Nothing less than a multilateral solution, however, will be acceptable to those who, following the Atlantic Charter, "desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement, and social security."

APPENDIX I

The White Plan

PRELIMINARY DRAFT OUTLINE OF A PROPOSAL FOR AN INTERNATIONAL STABILIZATION FUND OF THE UNITED AND ASSOCIATED NATIONS

REVISED July 10, 1943

Preamble

1. There is a growing recognition that progress toward establishment of a functioning democratic world in the post-war period will depend on the ability of free peoples to work together in solving their economic problems. Not the least of these is the problem of how to prevent a widespread breakdown of currencies with resultant international economic disorder. We must assure a troubled world that the free countries will solve these perplexing problems, and that they will not resort to competitive exchange depreciation, multiple currency practices, discriminatory bilateral clearing, or other destructive foreign exchange devices.

2. These are not transitory problems of the immediate post-war period affecting only a few countries. The history of the past two decades shows that they are continuing problems of vital interest to all countries. There must be a general realization that world prosperity, like world peace, is indivisible. Nations must act together to restore multilateral international trade, and to provide orderly procedure for the maintenance of balanced economic growth. Only through international co-operation will it be possible for countries successfully to apply measures directed toward attaining and maintaining a high level of employment and income which must be the primary objective of economic policy.

3. The International Stabilization Fund of the United and Associated Nations is proposed as a permanent institution for

international monetary cooperation. The resources of this Fund would be available under adequate safeguards to maintain currency stability, while giving member countries time to correct maladjustments in their balance of payments without resorting to extreme measures destructive of international prosperity. The resources of the Fund would not be used to prolong a basically unbalanced international position. On the contrary, the Fund would be influential in inducing countries to pursue policies making for an orderly return to equilibrium.

4. The Fund would deal only with member governments and their fiscal agents, and would not intrude in the customary channels for conducting international commerce and finance. The Fund is intended to provide supplemental facilities for the successful functioning of the established foreign exchange institutions and to free international commerce from harmful restrictions.

5. The success of the Fund must ultimately depend upon the willingness of nations to act together on their common problems. International monetary cooperation should not be regarded as a matter of generosity. All countries have a vital interest in the maintenance of international monetary stability, and in the balanced growth of multilateral international trade.

I. Purposes of the Fund

The United Nations and the countries associated with them recognize, as declared in the Atlantic Charter, the need for the fullest cooperation among nations with the object of securing economic advancement and rising standards of living for all. They believe that attainment of these objectives will be facilitated by international monetary cooperation. Therefore, it is proposed that there be established an International Stabilization Fund with the following purposes:

1. To help stabilize the foreign exchange rates of the currencies of the United Nations and the countries associated with them.

2. To shorten the periods and lessen the degree of disequilibrium in the international balance of payments of member countries.

3. To help create conditions under which the smooth flow of foreign trade and of productive capital among the member countries will be fostered.

4. To facilitate the effective utilization of the blocked foreign balances accumulating in some countries as a consequence of the war situation.

5. To reduce the use of such foreign exchange restrictions, bilateral clearing arrangements, multiple currency devices, and discriminatory foreign exchange practices as hamper world trade and the international flow of productive capital.

II. Composition of the Fund

1. The Fund shall consist of gold and the currencies and securities of member governments.

2. Each of the member countries shall subscribe a specified amount, to be called its *quota*. The aggregate of quotas of the member countries shall be the equivalent of at least $5 billion.

3. Each member country shall meet its quota contribution in full on or before the date set by the Board of Directors for the Fund's operations to begin.

(*a*) A country shall pay in gold not less than an amount determined as follows. If its gold and free foreign exchange holdings are:

(i) In excess of three times its quota, it shall pay in gold 50 percent of its quota.

(ii) More than two but less than three times its quota, it shall pay in gold 40 percent of its quota plus 10 percent of its holdings in excess of twice its quota.

(iii) More than its quota but less than twice its quota, it shall pay in gold 30 percent of its quota plus 10 percent of its holdings in excess of its quota.

(iv) Less than its quota, it shall pay in gold 30 percent of its holdings.

The gold payment required of a member country substantial parts of whose home areas have been wholly or partly occupied by the enemy, shall be only three-fourths of the above. (For other gold provisions, Cf. v-2-a and v-6, 7.)

A member country may include in the legal reserve account and in the published statement of the reserves of gold and foreign exchange in its Treasury or Central Bank, an amount not to exceed its gold contribution to the Fund, minus its net purchases of foreign exchange from the Fund paid for with local currency.

(*b*) It shall pay the remainder of its quota in local currency, except that a member country may substitute government securities (redeemable at par) for local currency up to 50 percent of its quota.

4. A quota for each member country shall be computed by an agreed upon formula which gives due weight to the important relevant factors, e.g., a country's holdings of gold and free foreign exchange, the magnitude and the fluctuations of its balance of international payments, its national income, etc.

Before computing individual quotas on the basis of the agreed upon formula, there shall be reserved an amount equal to 10 percent of aggregate quotas to be used as a special allotment for the equitable adjustment of quotas. Where the initial quota of a member country as computed by the formula is clearly inequitable, the quota may be increased from this special allotment.

5. Quotas shall be adjusted on the basis of the most recent data 3 years after the establishment of the Fund, and at intervals of 5 years thereafter, in accordance with the agreed upon formula. In the period between adjustment of quotas, the Fund may increase the quota of a country, where it is clearly inequitable, out of the special allotment reserved for the equitable adjustment of quotas.

6. Any changes in the formula by which the quotas of member countries are determined shall be made only with the approval of a four-fifths vote of the Board.

7. No increase shall be made in the quota of a member country under II-4, 5 or 6 without the consent of the representative of the country concerned.

8. The resources of the Fund shall be used exclusively for the benefit of the member countries.

III. Monetary Unit of the Fund

1. The monetary unit of the Fund shall be the *unitas* (~~UN~~) equal in value to 137 1/7 grains of fine gold (equivalent to $10). No change in the gold value of the unitas shall be made except with the approval of 85 percent of the member votes. When such change is made, the gain or loss sustained by the Fund on its holdings of gold shall be distributed equitably among the members of the Fund.

The accounts of the Fund shall be kept and published in terms of unitas.

2. The value of the currency of each member country shall be established in terms of unitas and may not be altered except as provided in IV-5, below. (Cf. IV-1, 2, below.)

No member country shall purchase or acquire gold, directly or indirectly, at a price in terms of its national currency in excess of the parity which corresponds to the value of its currency in terms of unitas and to the value of unitas in terms of gold; nor shall any member country sell or dispose of gold, directly or indirectly, at a price in terms of its national currency below the parity which corresponds to the value of its currency in terms of unitas and to the value of unitas in terms of gold. (Cf. VII-1.)

3. No change in the value of the currencies of member countries shall be permitted to alter the value in unitas of the assets of the Fund. Whenever the currency of a member country has depreciated to a significant extent, that country must deliver to the Fund when requested an amount of its local currency or securities equal to the decrease in the unitas value of the Fund's holdings of the local currency and securities of the country. Likewise, if the currency of a member country should appreciate to a significant extent, the Fund must return to that country an amount (in the currency or securities of that country) equal to the resulting increase in the unitas value of the Fund's holdings.

IV. Exchange Rates

1. The rates at which the Fund will buy and sell one member currency for another and at which the Fund will buy and sell gold for local currency shall be established in accordance with the provisions below. (Cf. also III-2 and V-2.)

2. The initial rates of exchange for member countries' currencies shall be determined as follows:

(*a*) For any country which becomes a member prior to the date on which the Fund's operations begin, the rates initially used by the Fund shall be based upon the value of the currency in terms of United States dollars which prevailed on July 1, 1943.

If, in the judgment of either the member country or the Fund, the above rate is clearly inappropriate, the initial rate shall be determined by consultation between the member country and the Fund. No operations in such currency shall be undertaken by the Fund until a rate has been established which has the approval of the Fund and of the member country in question.

(*b*) For any member country which has been occupied by the enemy, the Fund shall use the exchange rate fixed by the government of the liberated country in consultation with the Fund and acceptable to the Fund. Prior to the fixing of a definitive rate, operations in such currency may be undertaken by the Fund with the approval of the Board at a tentative rate of exchange fixed by the member country in consultation with the Board. No operations shall be continued under this provision for more than 3 months after the liberation of the country or when the local currency holdings of the Fund exceed the quota of the country, except that under special circumstances the period and the amount of such operations may be extended by the Fund.

3. The Fund shall not come into operation until agreement has been reached on the exchange rates for currencies of countries representing a majority of the aggregate quotas.

4. The Fund shall determine the range within which the rates of exchange of member currencies shall be permitted to fluctuate. (Cf. VII-1.)

5. Changes in the exchange value of the currency of a member country shall be considered only when essential to the correction of fundamental disequilibrium in its balance of payments, and shall be made only with the approval of three-fourths of the member votes including the representative of the country concerned.

Because of the extreme uncertainties of the immediate post-war period, the following exceptional provisions may be used during the first 3 years of the Fund's operations:

(*a*) When the existing rate of exchange of a member country is clearly inconsistent with the maintenance of a balanced international payments position for that country, changes from the established rate may be made at the special request of that country and with the approval of a majority of the member votes.

(*b*) A member country may change the established rate for its currency by not more than 10 percent provided that the member country shall notify the Fund of its intention and shall consult with the Fund on the advisability of its action.

V. Powers and Operations

1. The Fund shall have the power to buy, sell and hold gold, currencies, and government securities of member countries; to earmark and transfer gold; to issue its own obligations, and to offer them for discount or sale in member countries.

The Fund shall purchase for local currency or needed foreign exchange any member currency in good standing acquired by another member country in settlement of a balance of payments on current account, where such currency cannot be disposed of in the foreign exchange markets within the range established by the Fund.

2. The Fund may sell to the Treasury of any member country (or Stabilization Fund or Central Bank acting as its agent) at

the accepted rate of exchange, currency of any member country which the Fund holds, provided that:

(*a*) The foreign exchange demanded from the Fund is required to meet an adverse balance of payments predominantly on current account with any member country. (Cf. V-3, for capital transfers.)

When the gold and free foreign exchange holdings of a member country exceed 50 percent of its quota, the Fund in selling foreign exchange to such member country shall require that one-half of such exchange shall be paid for with gold or foreign exchange acceptable to the Fund. (Cf. V-6, 7; on gold collateral, see V-2-c.)

(*b*) The Fund's total holdings of the currency and securities of any member country shall not exceed the quota of such country by more than 50 percent during the first year of operation of the Fund, and thereafter shall not exceed such quota by more than 100 percent (except as otherwise provided below). The total holdings thus permitted are termed the *permissible quota* of a country. When the Fund's holdings of local currency and securities are equal to the permissible quota of a country, the Fund may sell foreign exchange for such additional local currency only with the specific approval of the Board of Directors (cf. VI-3-a, below), and provided that at least one of the following two conditions is met:

(i) In the judgment of the Fund satisfactory measures are being or will be taken by the country whose currency is acquired by the Fund, to correct the disequilibrium in the country's balance of payments; or

(ii) It is believed that the balance of payments of the country whose currency is acquired by the Fund will be such as to warrant the expectation that the excess currency holdings of the Fund can be disposed of within a reasonable time;

Provided further, that when the Fund's holdings of the currency of any member country or countries fall below

20 percent of their respective quotas, the sale of such currencies shall also require the approval of the representatives of these countries.

(*c*) When the Fund's holdings of local currency and securities exceed the permissible quota of a country, the Board may require the member country to deposit collateral in accordance with regulations prescribed by the Board. Such collateral shall take the form of gold, foreign or domestic currency or Government bonds, or other suitable collateral within the capacity of the member country.

(*d*) When, in the judgment of the Fund, a member country, whose currency and securities held by the Fund exceed its quota, is exhausting its permissible quota more rapidly than is warranted, or is using its permissible quota in a manner that clearly has the effect of preventing or unduly delaying the establishment of a sound balance in its international accounts, the Fund may place such conditions upon additional sales of foreign exchange to that country as it deems to be in the general interest of the Fund.

3. The Fund may sell foreign exchange to a member country, under conditions prescribed by the Fund, to facilitate a transfer of capital, or repayment or adjustment of foreign debts, when in the judgment of the Board such a transfer is desirable from the point of view of the general international economic situation, provided the Fund's holdings of the currency and securities of the member country do not exceed 150 percent of the quota of that country. When the Fund's holdings of the local currency and securities of a member country exceed 150 percent of the quota of that country, the Fund may, in exceptional circumstances, sell foreign exchange to the member country for the above purposes with the approval of three-fourths of the member votes. (Cf. V-2-a, above; on voting, VI-3-a, below.)

4. When the Fund's holdings of the currency and securities of a member country become excessively small in relation to

prospective acquisitions and needs for that currency, the Fund shall render a report to that country. The report shall embody an analysis of the causes of the depletion of the Fund's holdings of that currency, a forecast of the prospective balance of payments in the absence of special measures, and finally, recommendations designed to increase the Fund's holdings of that currency. The representative of the country in question shall be a member of the Fund committee appointed to draft the report. This report shall be sent to all member countries and, if deemed desirable, be made public. Member countries agree that they will give immediate and careful attention to recommendations made by the Fund.

5. Whenever it becomes evident to the Board of Directors that the anticipated demand for any particular currency may soon exhaust the Fund's holdings of that currency, the Fund shall inform the member countries of the probable supply of the currency and of a proposed method for its equitable distribution, together with suggestions for helping to equate the anticipated demand for and supply of that currency.

The Fund shall make every effort to increase the supply of the scarce currency by acquiring that currency from the foreign balances of member countries. The Fund may make special arrangements with any member country for the purpose of providing an emergency supply under appropriate conditions which are acceptable to both the Fund and the member country.

To facilitate appropriate adjustment in the balance of payments position of member countries, and to help correct the distortions in the pattern of trade balances, the Fund shall apportion its sales of such scarce currency. In such apportionment, it shall be guided by the principle of satisfying the most urgent needs from the point of view of the general international economic situation. It shall also consider the special needs and resources of the particular countries making the request for the scarce currency.

The right of any member country to acquire an amount of other currencies equal to its permissible quota shall be limited by the necessity of assuring an appropriate distribution among

the various members of any currency the supply of which is scarce.

6. In order to promote the most effective use of the available and accumulating supply of foreign exchange resources of member countries, each member country agrees that it will offer to sell to the Fund, for its local currency or for foreign currencies which the member country needs, one-half of the foreign exchange resources and gold it acquires in excess of its official holdings at the time it became a member of the Fund, but no country need sell gold or foreign exchange under this provision unless its official holdings (i.e., Treasury, Central Bank, Stabilization Fund, etc.) are in excess of 25 percent of its quota. For the purpose of this provision, only free and liquid foreign exchange resources and gold shall be considered. The Fund may accept or reject the offer. (Cf. II-3-a, V-2-a, and V-7.)

To help achieve this objective each member country agrees to discourage the excessive accumulation of foreign exchange resources and gold by its nationals. The Fund shall inform any member country when, in its opinion, any further growth of privately held foreign exchange resources and gold appears unwarranted.

7. When the Fund's holdings of the local currency and securities of a member country exceed the quota of that country, the Fund shall, upon request of the member country, resell to the member country the Fund's excess holdings of the currency of that country for gold or acceptable foreign exchange. (Cf. V-14, for charges on holdings in excess of quota.)

8. To buy from the governments of member countries, blocked foreign balances held in other member countries, provided all the following conditions are met:

(*a*) The blocked balances are held in member countries and are reported as such (for the purpose of this provision) by the member governments and are verified by the Fund.

(*b*) The member country selling the blocked balances to the Fund agrees to transfer these balances to the Fund

and to repurchase from the Fund 40 percent of them (at the same price) with gold or such free currencies as the Fund may wish to accept, at the rate of 2 percent of the transferred balances each year for 20 years beginning not later than 3 years after the date of transfer.

(*c*) The country in which the blocked balances are held agrees to transfer to the Fund the balances described in (*b*) above, and to repurchase from the Fund 40 percent of them (at the same price) with gold or such free currencies as the Fund may wish to accept, at the rate of 2 percent of the transferred balances each year for 20 years beginning not later than 3 years after the date of transfer.

(*d*) A charge of 1 percent on the amount of blocked balances sold to the Fund, payable in gold, shall be levied against the country selling its blocked balances and against the country in which the balances are held. In addition a charge of not less than one percent, payable in gold, shall be levied annually against each country on the amount of such balances remaining to be purchased by it.

(*e*) If the country selling blocked balances to the Fund asks for foreign exchange rather than local currency, the request will not be granted unless the country needs the foreign exchange for the purpose of meeting an adverse balance of payments not arising from the acquisition of gold, the accumulation of foreign balances, or other capital transactions.

(*f*) Either country may, at its option, increase the amount it repurchases annually. But, in the case of the country selling blocked balances to the Fund, not more than 2 per cent per annum of the original sum taken over by the Fund shall become free, and only after 3 years shall have elapsed since the sale of the balances to the Fund.

(*g*) The Fund has the privilege of disposing of any of its holdings of blocked balances as free funds after the 23-

year period is passed, or sooner under the following conditions:

(i) Its holdings of the free funds of the country in which the balances are held fall below 20 percent of its quota; or

(ii) The approval is obtained of the country in which the balances are held.

(*h*) The country in which the blocked balances are held agrees not to impose any restrictions on the use of the installments of the 40 percent portion gradually repurchased by the country which sold the balances to the Fund.

(*i*) The Fund agrees not to sell the blocked balances acquired under the above authority, except with the permission or at the request of the country in which the balances are being held. The Fund may invest these balances in the ordinary or special government securities of that country. The Fund shall be free to sell such securities in any country under the provisions of V-11, below.

(*j*) The Fund shall determine from time to time the maximum proportion of the blocked balances it will purchase under this provision.

Provided, however, that during the first 2 years of its operation, blocked balances purchased by the Fund shall not exceed in the aggregate 10 percent of the quotas of all member countries. At the end of 2 years of operation, the Fund shall propose a plan for the gradual further liquidation of blocked balances still outstanding indicating the proportion of the blocked balances which the Board considers the Fund can appropriately purchase.

Blocked balances acquired under this provision shall not be included either in computing the amount of foreign exchange available to member countries under their quotas (cf. V-2, 3), or in computing charges on balances of local currency in excess of the quotas (cf. V-14).

9. To buy and sell currencies of non-member countries but shall not acquire more than $10 million of the currency of any one non-member country nor hold such currencies beyond 60 days after date of purchase except with the approval of the Board.

10. To borrow the currency of any member country provided the additional amount is needed by the Fund and provided the representative of that country approves.

11. To sell member-country obligations owned by the Fund provided that the representatives of the country issuing the securities and of the country in which the securities are to be sold approve, except that the approval of the representative of the issuing country shall not be necessary if the obligations are to be sold in its own market.

To use its holdings to obtain rediscounts or advances from the Central Bank of any country whose currency the Fund needs.

12. To invest any of its currency holdings in government securities of the country of that currency provided that the representative of the country approves.

13. To lend to any member country its local currency from the Fund for 1 year or less up to 75 percent of the currency of that country held by the Fund, provided the local currency holdings of the Fund are not reduced below 20 percent of the quota.

14. To make a service charge on all gold and exchange transactions.

To levy a charge uniform to all countries, at a rate not less than 1 percent per annum, payable in gold, against any country on the amount of its currency held by the Fund in excess of the quota of that country. An additional charge, payable in gold, shall be levied by the Fund against any member country on the Fund's holdings of its currency in excess of the permissible quota of that country.

In case the Funds finds it necessary to borrow currency to meet the demands of its members, an additional charge, payable in gold, shall be made by the Fund sufficient to cover the cost of the borrowing.

15. To levy upon member countries a *pro rata* share of the

expenses of operating the Fund, payable in local currency, not to exceed one-tenth percent per annum of the quota of each country. The levy may be made only to the extent that the earnings of the Fund are inadequate to meet its current expenses.

16. The Fund shall deal only with or through:

(*a*) The Treasuries, Stabilization Funds, or Central Banks acting as fiscal agents of member governments.

(*b*) Any international banks owned predominantly by member governments.

The Fund may, nevertheless, with the approval of the representatives of the governments of the countries concerned, sell its own securities, or securities it holds, directly to the public or to institutions of member countries.

VI. Management

1. The administration of the Fund shall be vested in a Board of Directors. Each government shall appoint a director and an alternate, in a manner determined by it, who shall serve for a period of 5 years, subject to the pleasure of their government. Directors and alternates may be reappointed.

2. In all voting by the Board, the director or alternate of each member country shall be entitled to cast an agreed upon number of votes.

The distribution of *basic votes* shall be closely related to the quotas of member countries, although not in precise proportion to the quotas. An appropriate distribution of basic voting power would seem to be the following: Each country shall have 100 votes, plus 1 vote for the equivalent of each 100,000 unitas ($1 million) of its quota.

No country shall be entitled to cast more than one-fifth of the aggregate basic votes, regardless of its quota.

3. All voting shall be according to basic votes except as follows:

(*a*) In voting on proposals to authorize the sale of foreign exchange, each country shall cast a number of votes modified from its basic vote:

(i) By the addition of one vote for each \$2 million of net sales of its currency by the Fund (adjusted for its net transactions in gold), and

(ii) By the subtraction of one vote for each \$2 million of its net purchases of foreign exchange from the Fund (adjusted for its net transactions in gold).

(*b*) In voting on proposals to suspend or restore membership, each member country shall cast one vote, as provided in VI-11, below.

4. All decisions, except where specifically provided otherwise, shall be made by a majority of the member votes.

5. The Board of Directors shall select a Managing Director of the Fund and one or more assistants. The Managing Director shall become an *ex officio* member of the Board and shall be chief of the operating staff of the Fund. The operating staff shall be selected in accordance with regulations established by the Board of Directors.

6. The Board of Directors shall appoint from among its members an Executive Committee of not less than 11 members. The Chairman of the Board shall be Chairman of the Executive Committee, and the Managing Director of the Fund shall be an *ex officio* member of the Executive Committee.

The Executive Committee shall be continuously available at the head office of the Fund and shall exercise the authority delegated to it by the Board. In the absence of any member of the Executive Committee, his alternate shall act in his place. Members of the Executive Committee shall receive appropriate remuneration.

7. The Board of Directors may appoint such other committees as it finds necessary for the work of the Fund. It may also appoint advisory committees chosen wholly or partially from persons not employed by the Fund.

8. The Board of Directors may at any meeting authorize any officers or committees of the Fund to exercise any specified powers of the Board not requiring more than a majority vote.

The Board may delegate any authority to the Executive Committee, provided that the delegation of powers requiring

more than a majority of the member votes can be authorized only by a majority (of the Board) of the same size as specified, and can be exercised by the Executive Committee only by like majority.

Delegated powers shall be exercised only until the next meeting of the Board, and in a manner consistent with the general policies and practices of the Board.

9. The Board of Directors may establish procedural regulations governing the operations of the Fund. The officers and committees of the Fund shall be bound by such regulations.

10. The Board of Directors shall hold an annual meeting and such other meetings as it may be desirable to convene. The annual meeting shall be held in places designated by the Executive Committee, but not more than one annual meeting in any 5-year period shall be held within the same member country.

On request of member countries casting one-fourth of the votes, the Chairman shall call a meeting of the Board for the purpose of considering any matters placed before it.

11. A country failing to meet its obligations to the Fund may be suspended provided a majority of the member countries so decides. While under suspension, the country shall be denied the privileges of membership but shall be subject to the same obligations as any other member of the Fund. At the end of 1 year the country shall be automatically dropped from membership unless it has been restored to good standing by a majority of the member countries.

Any country may withdraw from the Fund by giving notice, and its withdrawal will take effect 1 year from the date of such notice. During the interval between notice of withdrawal and the taking effect of the notice, such country shall be subject to the same obligations as any other member of the Fund.

A country which is dropped or which withdraws from the Fund shall have returned to it an amount in its own currency equal to its contributed quota, plus other obligations of the Fund to the country, and minus any sum owed by that country to the Fund. Any losses of the Fund may be deducted *pro rata* from the contributed quota to be returned to the country that

has been dropped or has withdrawn from membership. Local currency holdings of the Fund in excess of the above shall be repurchased by that country with gold or foreign exchange acceptable to the Fund.

When any country is dropped or withdraws from membership, the rights of the Fund shall be fully safeguarded. The obligations of a country to the Fund shall become due at the time it is dropped or withdraws from membership; but the Fund shall have 5 years within which to liquidate its obligations to such country.

12. Net profits earned by the Fund shall be distributed in the following manner:

(*a*) Fifty percent to reserves until the reserves are equal to 10 percent of the aggregate quotas of the Fund.

(*b*) Fifty percent to be divided each year among the members in proportion to their quotas. Dividends distributed to each country shall be paid in its own currency or in gold at the discretion of the Fund.

VII. Policies of Member Countries

Each member country of the Fund undertakes the following:

1. To maintain by appropriate action exchange rates established by the Fund on the currencies of other countries, and not to alter exchange rates except as provided in IV-5, above.

Exchange rates of member countries may be permitted to fluctuate within the specified range fixed by the Fund.

2. Not to engage in exchange dealings with member or non-member countries that will undermine stability of exchange rates established by the Fund.

3. To abandon, as soon as the member country decides that conditions permit, all restrictions (other than those involving capital transfers) over foreign exchange transactions with other member countries, and not to impose any additional restrictions (except upon capital transfers) without the approval of the Fund.

The Fund may make representations to member countries

that conditions are favorable for the abandonment of restrictions over foreign exchange transactions, and each member country shall give consideration to such representations.

All member countries agree that all of the local currency holdings of the Fund shall be free from any restrictions as to their use. This provision does not apply to blocked foreign balances acquired by the Fund in accordance with the provisions of V-8, above.

4. To cooperate effectively with other member countries when such countries, with the approval of the Fund, adopt or continue controls for the purpose of regulating international movements of capital. Cooperation shall include, upon recommendation by the Fund, measures that can appropriately be taken, such as:

(*a*) Not to accept or permit acquisition of deposits, securities, or investments by nationals of any member country imposing restrictions on the export of capital except with the permission of the government of that country and the Fund;

(*b*) To make available to the Fund or to the government of any member country such information as the Fund considers necessary on property in the form of deposits, securities and investments of the nationals of the member country imposing the restrictions.

5. Not to enter upon any new bilateral clearing arrangements, nor engage in multiple currency practices, which in the judgment of the Fund would retard the growth of world trade or the international flow of productive capital.

6. To give consideration to the views of the Fund on any existing or proposed monetary or economic policy, the effect of which would be to bring about sooner or later a serious disequilibrium in the balance of payments of other countries.

7. To furnish the Fund with all information it needs for its operations and to furnish such reports as the Fund may require in the form and at the times requested by the Fund.

8. To adopt appropriate legislation or decrees to carry out its undertakings to the Fund.

APPENDIX II

The Keynes Plan

PROPOSALS FOR AN INTERNATIONAL CLEARING UNION

APRIL 8, 1943

Preface

Immediately after the war, all countries which have been engaged will be concerned with the pressure of relief and urgent reconstruction. The transition out of this into the normal world of the future cannot be wisely effected unless we know into what we are moving. It is therefore not too soon to consider what is to come after. In the field of national activity occupied by production, trade and finance, both the nature of the problem and the experience of the period between wars suggest four main lines of approach.

1. The mechanism of currency and exchange.
2. The framework of a commercial policy regulating conditions for exchange of goods, tariffs, preferences, subsidies, import regulations and the like.
3. Orderly conduct of production, distribution and price of primary products so as to protect both producers and consumers from the loss and risk for which extravagant fluctuations of market conditions have been responsible in recent times.
4. Investment aid, both medium and long term, for countries whose economic development needs assistance from outside.

If the principles of these measures and the form of institutions to give effect to them can be settled in advance, in order that they may be in operation when need arises, it is possible that taken together they may help the world to control the ebb and flow of the tides of economic activity which have, in the past, destroyed security of livelihood and endangered international peace.

All these matters will need to be handled in due course. The proposal that follows relates only to the mechanism of currency

and exchange in international trading. It appears on the whole convenient to give it priority, because some general conclusions have to be reached under this head before much progress can be made with other topics.

In preparing these proposals care has been taken to regard certain conditions, which the groundwork of an international economic system to be set up after the war should satisfy if it is to prove durable.

(1) There should be the least possible interference with internal national policies, and the plan should not wander from the international *terrain*. Since such policies may have important repercussions on international relations they cannot be left out of account. Nevertheless, in the realm of internal policy, the authority of the governing board of the proposed institution should be limited to recommendations, or, at most, to imposing conditions for more extended enjoyment of the facilities which the institution offers.

(2) The technique of the plan must be capable of application irrespective of the type and principle of government and the economic policy existing in the prospective member States.

(3) Management of the institution must be genuinely international, without preponderant power of veto or enforcement lying with any country or group. And the rights and privileges of smaller countries must be safeguarded.

(4) Some qualification of the right to act at pleasure is required by any agreement or treaty between Nations. But in order that such arrangements may be fully voluntary so long as they last and terminable when they have become irksome, provision must be made for voiding the obligation at due notice. If many member States were to take advantage of this, the plan would have broken down, but if they are free to escape from its provisions if necessary, they may be more willing to go on accepting them.

(5) The plan must operate not only to the general advantage but also to the individual advantage of each of the participants, and must not require a special economic or financial sacrifice from certain countries. No participant must be asked to do or offer anything which is not to his own true long-term interest.

It must be emphasized that it is not for the Clearing Union to assume the burden of long term lending which is the proper task of some other institution. It is also necessary for it to have the means of restraining improvident borrowers. But the Clearing Union must also seek to discourage creditor countries from having unused large liquid balances which ought to be devoted to some positive purpose. For excessive credit balances necessarily create excessive debit balances for some other party. In recognising that the creditor as well as the debtor may be responsible for a want of balance, the proposed institution would be breaking new ground.

I. The Objects of the Plan

1. About the primary objects of an improved system of International Currency there is, to-day, a wide measure of agreement:—

(*a*) We need an instrument of international currency having general acceptability between nations, so that blocked balances and bilateral clearings are unnecessary; that is to say, an instrument of currency used by each nation in its transactions with other nations, operating through whatever national organ, such as a Treasury or a Central Bank, is most appropriate, private individuals, businesses and banks other than Central Banks, each continuing to use their own national currency as heretofore.

(*b*) We need an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations are prevented.

(*c*) We need a *quantum* of international currency, which is neither determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries; but is governed by the actual current requirements of world commerce, and is also capable of deliberate expansion

and contraction to offset deflationary and inflationary tendencies in effective world demand.

(*d*) We need a system possessed of an internal stabilising mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction, so as to prevent movements which must create for its neighbours an equal but opposite want of balance.

(*e*) We need an agreed plan for starting off every country after the war with a stock of reserves appropriate to its importance in world commerce, so that without due anxiety it can set its house in order during the transitional period to full peace-time conditions.

(*f*) We need a central institution, of a purely technical and non-political character, to aid and support other international institutions concerned with the planning and regulation of the world's economic life.

(*g*) More generally, we need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety, for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self-protection from disruptive outside forces.

2. There is also a growing measure of agreement about the general character of any solution of the problem likely to be successful. The particular proposals set forth below lay no claim to originality. They are an attempt to reduce to practical shape certain general ideas belonging to the contemporary climate of economic opinion, which have been given publicity in recent months by writers of several different nationalities. It is difficult to see how any plan can be successful which does not use these general ideas, which are born of the spirit of the age. The actual details put forward below are offered, with no dogmatic

intention, as the basis of discussion for criticism and improvement. For we cannot make progress without embodying the general underlying idea in a frame of actual working, which will bring out the practical and political difficulties to be faced and met if the breath of life is to inform it.

3. In one respect this particular plan will be found to be more ambitious and yet, at the same time, perhaps more workable than some of the variant versions of the same basic idea, in that it is fully international, being based on one general agreement and not on a multiplicity of bilateral arrangements. Doubtless proposals might be made by which bilateral arrangements could be fitted together so as to obtain some of the advantages of a multilateral scheme. But there will be many difficulties attendant on such adjustments. It may be doubted whether a comprehensive scheme will ever in fact be worked out, unless it can come into existence through a single act of creation made possible by the unity of purpose and energy of hope for better things to come, springing from the victory of the United Nations, when they have attained it, over immediate evil. That these proposals are ambitious is claimed, therefore to be not a drawback but an advantage.

4. The proposal is to establish a Currency Union, here designated an *International Clearing Union*, based on international bank-money, called (let us say) *bancor*, fixed (but not unalterably) in terms of gold and accepted as the equivalent of gold by the British Commonwealth and the United States and all the other members of the Union for the purpose of settling international balances. The Central Banks of all member States (and also of non-members) would keep accounts with the International Clearing Union through which they would be entitled to settle their exchange balances with one another at their par value as defined in terms of bancor. Countries having a favourable balance of payments with the rest of the world as a whole would find themselves in possession of a credit account with the Clearing Union, and those having an unfavourable balance would have a debit account. Measures would be necessary (see below) to prevent the piling up of credit and debit balances without limit, and the system would have failed

in the long run if it did not possess sufficient capacity for self-equilibrium to secure this.

5. The idea underlying such a Union is simple, namely, to generalise the essential principle of banking as it is exhibited within any closed system. This principle is the necessary equality of credits and debits. If no credits can be removed outside the clearing system, but only transferred within it, the Union can never be in any difficulty as regards the honouring of cheques drawn upon it. It can make what advances it wishes to any of its members with the assurance that the proceeds can only be transferred to the clearing account of another member. Its sole task is to see to it that its members keep the rules and that the advances made to each of them are prudent and advisable for the Union as a whole.

II. The Provisions of the Plan

6. The provisions proposed (the particular proportions and other details suggested being tentative as a basis of discussion) are the following:—

(1) All the United Nations will be invited to become original members of the International Clearing Union. Other States may be invited to join subsequently. If ex-enemy States are invited to join, special conditions may be applied to them.

(2) The Governing Board of the Clearing Union shall be appointed by the Governments of the several member States, as provided in (12) below; the daily business with the Union and the technical arrangements being carried out through their Central Banks or other appropriate authorities.

(3) The member States will agree between themselves the initial values of their own currencies in terms of bancor. A member State may not subsequently alter the value of its currency in terms of bancor without the permission of the Governing Board except under the conditions stated below; but during the first five years after the inception of the system the Governing Board shall give special consideration to appeals for an adjustment in the exchange value of a national currency unit on the ground of unforeseen circumstances.

(4) The value of bancor in terms of gold shall be fixed by

the Governing Board. Member States shall not purchase or acquire gold, directly or indirectly, at a price in terms of their national currencies in excess of the parity which corresponds to the value of their currency in terms of bancor and to the value of bancor in terms of gold. Their sales and purchases of gold shall not be otherwise restricted.

(5) Each member State shall have assigned to it a *quota,* which shall determine the measure of its responsibility in the management of the Union and of its right to enjoy the credit facilities provided by the Union. The initial quotas might be fixed by reference to the sum of each country's exports and imports on the average of (say) the three pre-war years, and might be (say) 75 percent of this amount, a special assessment being substituted in cases (of which there might be several) where this formula would be, for any reason, inappropriate. Subsequently, after the elapse of the transitional period, the quotas should be revised annually in accordance with the running average of each country's actual volume of trade in the three preceding years, rising to a five-year average when figures for five post-war years are available. The determination of a country's quota primarily by reference to the value of its foreign trade seems to offer the criterion most relevant to a plan which is chiefly concerned with the regulation of the foreign exchanges and of a country's international trade balance. It is, however, a matter for discussion whether the formula for fixing quotas should also take account of other factors.

(6) Member States shall agree to accept payment of currency balances, due to them from other members, by a transfer of bancor to their credit in the books of the Clearing Union. They shall be entitled, subject to the conditions set forth below, to make transfers of bancor to other members which have the effect of overdrawing their own accounts with the Union, provided that the maximum debit balances thus created do not exceed their quota. The Clearing Union may, at its discretion, charge a small commission or transfer fee in respect of transactions in its books for the purpose of meeting its current expenses or any other outgoings approved by the Governing Board.

(7) A member State shall pay to the Reserve Fund of the

Clearing Union a charge of 1 percent per annum on the amount of its average balance in bancor, whether it is a credit or a debit balance, in excess of a quarter of its quota; and a further charge of 1 percent on its average balance, whether credit or debit, in excess of a half of its quota. Thus, only a country which keeps as nearly as possible in a state of international balance on the average of the year will escape this contribution. These charges are not absolutely essential to the scheme. But if they are found acceptable, they would be valuable and important inducements towards keeping a level balance, and a significant indication that the system looks on excessive credit balances with as critical an eye as on excessive debit balances, each being, indeed, the inevitable concomitant of the other. Any member State in debit may, after consultation with the Governing Board, borrow bancor from the balances of any member State in credit on such terms as may be mutually agreed, by which means each would avoid these contributions. The Governing Board may, at its discretion, remit the charges on credit balances, and increase correspondingly those on debit balances, if in its opinion unduly expansionist conditions are impending in the world economy.

(8)—(*a*) A member State may not increase its debit balance by more than a *quarter* of its quota within a year without the permission of the Governing Board. If its debit balance has exceeded a quarter of its quota on the average of at least two years, it shall be entitled to reduce the value of its currency in terms of bancor provided that the reduction shall not exceed 5 percent without the consent of the Governing Board; but it shall not be entitled to repeat this procedure unless the Board is satisfied that this procedure is appropriate.

(*b*) The Governing Board may require from a member State having a debit balance reaching a *half* of its quota the deposit of suitable collateral against its debit balance. Such collateral shall, at the discretion of the Governing Board, take the form of gold, foreign or domestic currency or Government bonds, within the capacity of the member State. As a condition of allowing a member State to increase its debit balance to a figure in excess of a half of its quota, the Governing Board may require all or any of the following measures:—

(i) a stated reduction in the value of the member's currency, if it deems that to be the suitable remedy;

(ii) the control of outward capital transactions if not already in force; and

(iii) the outright surrender of a suitable proportion of any separate gold or other liquid reserve in reduction of its debit balance.

Furthermore, the Governing Board may recommend to the Government of the member State any internal measures affecting its domestic economy which may appear to be appropriate to restore the equilibrium of its international balance.

(*c*) If a member State's debit balance has exceeded *three-quarters* of its quota on the average of at least a year and is excessive in the opinion of the Governing Board in relation to the total debit balances outstanding on the books of the Clearing Union, or is increasing at an excessive rate, it may, in addition, be asked by the Governing Board to take measures to improve its position, and, in the event of its failing to reduce its debit balance accordingly within two years, the Governing Board may declare that it is in default and no longer entitled to draw against its account except with the permission of the Governing Board.

(*d*) Each member State, on joining the system, shall agree to pay to the Clearing Union any payments due from it to a country in default towards the discharge of the latter's debit balance and to accept this arrangement in the event of falling into default itself. A member State which resigns from the Clearing Union without making approved arrangements for the discharge of any debit balance shall also be treated as in default.

(9) A member State whose credit balance has exceeded *half* of its quota on the average of at least a year shall discuss with the Governing Board (but shall retain the ultimate decision in its own hands) what measures would be appropriate to restore the equilibrium of its international balances, including—

(*a*) Measures for the expansion of domestic credit and domestic demand.

(*b*) The appreciation of its local currency in terms of bancor, or, alternatively, the encouragement of an increase in money rates of earnings.
(*c*) The reduction of tariffs and other discouragements against imports.
(*d*) International development loans.

(10) A member State shall be entitled to obtain a credit balance in terms of bancor by paying in gold to the Clearing Union for the credit of its clearing account. But no one is entitled to demand gold from the Union against a balance of bancor, since such balance is available only for transfer to another clearing account. The Governing Board of the Union shall, however, have the discretion to distribute any gold in the possession of the Union between the members possessing credit balances in excess of a specified proportion of their quotas, proportionately to such balances, in reduction of their amount in excess of that proportion.

(11) The monetary reserves of a member State, viz., the Central Bank or other bank or Treasury deposits in excess of a working balance, shall not be held in another country except with the approval of the monetary authorities of that country.

(12) The Governing Board shall be appointed by the Governments of the member States, those with the larger quotas being entitled to appoint a member individually, and those with smaller quotas appointing in convenient political or geographical groups, so that the members would not exceed (say) 12 or 15 in number. Each representative on the Governing Board shall have a vote in proportion to the quotas of the State (or States) appointing him, except that on a proposal to increase a particular quota, a representative's voting power shall be measured by the quotas of the member States appointing him, increased by their credit balance or decreased by their debit balance, averaged in each case over the past two years. Each member State, which is not individually represented on the Governing Board, shall be entitled to appoint a permanent delegate to the Union to maintain contact with the Board and to act as *liaison* for daily business and for the exchange of in-

formation with the Executive of the Union. Such delegate shall be entitled to be present at the Governing Board when any matter is under consideration which specially concerns the State he represents, and to take part in the discussion.

(13) The Governing Board shall be entitled to reduce the quotas of members, all in the same specified proportion, if it seems necessary to correct in this manner an excess of world purchasing power. In that event, the provisions of 6 (8) shall be held to apply to the quotas as so reduced, provided that no member shall be required to reduce his actual overdraft at the date of the change, or be entitled by reason of this reduction to alter the value of his currency under 6 (8) (*a*), except after the expiry of two years. If the Governing Board subsequently desires to correct a potential deficiency of world purchasing power, it shall be entitled to restore the general level of quotas towards the original level.

(14) The Governing Board shall be entitled to ask and receive from each member State any relevant statistical or other information, including a full disclosure of gold, external credit and debit balances and other external assets and liabilities, both public and private. So far as circumstances permit, it will be desirable that the member States shall consult with the Governing Board on important matters of policy likely to affect substantially their bancor balances or their financial relations with other members.

(15) The executive offices of the Union shall be situated in London and New York, with the Governing Board meeting alternately in London and Washington.

(16) Members shall be entitled to withdraw from the Union on a year's notice, subject to their making satisfactory arrangements to discharge any debit balance. They would not, of course, be able to employ any credit balance except by making transfers from it, either before or after their withdrawal, to the Clearing Accounts of other Central Banks. Similarly, it should be within the power of the Governing Board to require the withdrawal of a member, subject to the same notice, if the latter is in breach of agreements relating to the Clearing Union.

(17) The Central Banks of non-member States would be

allowed to keep credit clearing accounts with the Union; and, indeed, it would be advisable for them to do so for the conduct of their trade with member States. But they would have no right to overdrafts and no say in the management.

(18) The Governing Board shall make an annual Report and shall convene an annual Assembly at which every member State shall be entitled to be represented individually and to move proposals. The principles and governing rules of the Union shall be the subject of reconsideration after five years' experience, if a majority of the Assembly desire it.

III. What Liabilities Ought the Plan to Place on Creditor Countries?

7. It is not contemplated that either the debit or the credit balance of an individual country ought to exceed a certain maximum—let us say, its *quota*. In the case of debit balances this maximum has been made a rigid one, and, indeed, countermeasures are called for long before the maximum is reached. In the case of credit balances no rigid maximum has been proposed. For the appropriate provision might be to require the eventual cancellation or compulsory investment of persistent bancor credit balances accumulating in excess of a member's quota; and, however desirable this may be in principle, it might be felt to impose on creditor countries a heavier burden than they can be asked to accept before having had experience of the benefit to them of the working of the plan as a whole. If, on the other hand, the limitation were to take the form of the creditor country not being required to accept bancor in excess of a prescribed figure, this might impair the general acceptability of bancor, whilst at the same time conferring no real benefit on the creditor country itself. For, if it chose to avail itself of the limitation, it must either restrict its exports or be driven back on some form of bilateral payments agreements outside the Clearing Union, thus substituting a less acceptable asset for bancor balances which are based on the collective credit of all the member States and are available for payments to any of them, or attempt the probably temporary expedient of refusing to trade except on a gold basis.

8. The absence of a rigid maximum to credit balances does not impose on any member State, as might be supposed at first sight, an unlimited liability outside its own control. The liability of an individual member is determined, not by the quotas of the other members, but by its own policy in controlling its favourable balance of payments. The existence of the Clearing Union does not deprive a member State of any of the facilities which it now possesses for receiving payment for its exports. In the absence of the Clearing Union a creditor country can employ the proceeds of its exports to buy goods or to buy investments, or to make temporary advances and to hold temporary overseas balances, or to buy gold in the market. All these facilities will remain at its disposal. The difference is that in the absence of the Clearing Union, more or less automatic factors come into play to restrict the volume of its exports after the above means of receiving payment for them have been exhausted. Certain countries become unable to buy and, in addition to this, there is an automatic tendency towards a general slump in international trade and, as a result, a reduction in the exports of the creditor country. Thus, the effect of the Clearing Union is to give the creditor country a choice between voluntarily curtailing its exports to the same extent that they would have been involuntarily curtailed in the absence of the Clearing Union, or, alternatively, of allowing its exports to continue and accumulating the excess receipts in the form of bancor balances for the time being. Unless the removal of a factor causing the involuntary reduction of exports is reckoned a disadvantage, a creditor country incurs no burden but is, on the contrary, relieved, by being offered the additional option of receiving payment for its exports through the accumulation of a bancor balance.

9. If, therefore, a member State asks what governs the maximum liability which it incurs by entering the system, the answer is that this lies entirely within its own control. No more is asked of it than that it should hold in bancor such surplus of its favourable balance of payments as it does not itself choose to employ in any other way, and only for so long as it does not so choose.

IV. Some Advantages of the Plan

10. The plan aims at the substitution of an expansionist, in place of a contractionist, pressure on world trade.

11. It effects this by allowing to each member State overdraft facilities of a defined amount. Thus each country is allowed a certain margin of resources and a certain interval of time within which to effect a balance in its economic relations with the rest of the world. These facilities are made possible by the constitution of the system itself and do not involve particular indebtedness between one member State and another. A country is in credit or debit with the Clearing Union as a whole. This means that the overdraft facilities, whilst a relief to some, are not a real burden to others. For the accumulation of a credit balance with the Clearing Union would resemble the importation of gold in signifying that the country holding it is abstaining voluntarily from the immediate use of purchasing power. But it would not involve, as would the importation of gold, the withdrawal of this purchasing power from circulation or the exercise of a deflationary and contractionist pressure on the whole world, including in the end the creditor country itself. Under the proposed plan, therefore, no country suffers injury (but on the contrary) by the fact that the command over resources, which it does not itself choose to employ for the time being, is not withdrawn from use. The accumulation of bancor credit does not curtail in the least its capacity or inducement either to produce or to consume.

12. In short, the analogy with a national banking system is complete. No depositor in a local bank suffers because the balances, which he leaves idle, are employed to finance the business of someone else. Just as the development of national banking systems served to offset a deflationary pressure which would have prevented otherwise the development of modern industry, so by extending the same principle into the international field we may hope to offset the contractionist pressure which might otherwise overwhelm in social disorder and disappointment the good hopes of our modern world. The substitution of a credit mechanism in place of hoarding would have

repeated in the international field the same miracle, already performed in the domestic field, of turning a stone into bread.

13. There might be other ways of effecting the same objects temporarily or in part. For example, the United States might redistribute her gold. Or there might be a number of bilateral arrangements having the effect of providing international overdrafts, as, for example, an agreement by the Federal Reserve Board to accumulate, if necessary, a large sterling balance at the Bank of England, accompanied by a great number of similar bilateral arrangements, amounting to some hundreds altogether, between these and all the other banks in the world. The objection to particular arrangements of this kind, in addition to their greater complexity, is that they are likely to be influenced by extraneous, political reasons; that they put individual countries in a position of particular obligation towards others; and that the distribution of the assistance between different countries may not correspond to need and to the real requirements, which are extremely difficult to foresee.

14. It should be much easier, and surely more satisfactory for all of us, to enter into a general and collective responsibility, applying to all countries alike, that a country finding itself in a creditor position *against the rest of the world as a whole* should enter into an arrangement not to allow this credit balance to exercise a contractionist pressure against world economy and, by repercussion, against the economy of the creditor country itself. This would give everyone the great assistance of multilateral clearing, whereby (for example) Great Britain could offset favourable balances arising out of her exports to Europe against unfavourable balances due to the United States or South America or elsewhere. How, indeed, can any country hope to start up trade with Europe during the relief and reconstruction period on any other terms?

15. The facilities offered will be of particular importance in the transitional period after the war, as soon as the initial shortages of supply have been overcome. Many countries will find a difficulty in paying for their imports, and will need time and resources before they can establish a readjustment. The efforts of each of these debtor countries to preserve its own equilib-

rium, by forcing its exports and by cutting off all imports which are not strictly necessary, will aggravate the problems of all the others. On the other hand, if each feels free from undue pressure, the volume of international exchange will be increased and everyone will find it easier to re-establish equilibrium without injury to the standard of life anywhere. The creditor countries will benefit, hardly less than the debtors, by being given an interval of *time* in which to adjust their economies, during which they can safely move at their own pace without the result of exercising deflationary pressure on the rest of the world, and, by repercussion, on themselves.

16. It must, however, be emphasized that the provision by which the members of the Clearing Union start with substantial overdraft facilities in hand will be mainly useful, just as the possession of any kind of reserve is useful, to allow time and method for necessary adjustments and a comfortable safeguard behind which the unforeseen and the unexpected can be faced with equanimity. Obviously, it does not by itself provide any long-term solution against a continuing disequilibrium, for in due course the more improvident and the more impecunious, left to themselves, would have run through their resources. But, if the purpose of the overdraft facilities is mainly to give time for adjustments, we have to make sure, so far as possible, that they *will* be made. We must have, therefore, some rules and some machinery to secure that equilibrium is restored. A tentative attempt to provide for this has been made above. Perhaps it might be strengthened and improved.

17. The provisions suggested differ in one important respect from the pre-war system because they aim at putting some part of the responsibility for adjustment on the creditor country as well as on the debtor. This is an attempt to recover one of the advantages which were enjoyed in the nineteenth century, when a flow of gold due to a favourable balance in favour of London and Paris, which were then the main creditor centres, immediately produced an expansionist pressure and increased foreign lending in those markets, but which has been lost since New York succeeded to the position of main creditor, as a result of gold movements failing in their effect, of the breakdown

of international borrowing and of the frequent flight of loose funds from one depository to another. The object is that the creditor should not be allowed to remain entirely passive. For if he is, an intolerably heavy task may be laid on the debtor country, which is already for that very reason in the weaker position.

18. If, indeed, a country lacks the productive capacity to maintain its standard of life, then a reduction in this standard is not avoidable. If its wage and price levels in terms of money are out of line with those elsewhere, a change in the rate of its foreign exchange is inevitable. But if, possessing the productive capacity, it lacks markets because of restrictive policies throughout the world, then the remedy lies in expanding its opportunities for export by removal of the restrictive pressure. We are too ready to-day to assume the inevitability of unbalanced trade positions, thus making the opposite error to those who assumed the tendency of exports and imports to equality. It used to be supposed, without sufficient reason, that effective demand is always properly adjusted throughout the world; we now tend to assume, equally without sufficient reason, that it never can be. On the contrary, there is great force in the contention that, if active employment and ample purchasing power can be sustained in the main centres of the world trade, the problem of surpluses and unwanted exports will largely disappear, even though, under the most prosperous conditions, there may remain some disturbances of trade and unforeseen situations requiring special remedies.

V. The Daily Management of the Exchanges under the Plan

19. The Clearing Union restores unfettered multilateral clearing between its members. Compare this with the difficulties and complications of a large number of bilateral agreements. Compare, above all, the provisions by which a country, taking improper advantage of a payments agreement (for the system is, in fact, a *generalized* payments agreement), as Germany did before the war, is dealt with not by a single country (which may not be strong enough to act effectively in isolation or cannot afford to incur the diplomatic odium of isolated action), but by the system as a whole. If the argument is used

that the Clearing Union may have difficulty in disciplining a misbehaving country and in avoiding consequential loss, with what much greater force can we urge this objection against a multiplicity of separate bilateral payments agreements.

20. Thus we should not only obtain the advantages, without the disadvantages, of an international gold currency, but we might enjoy these advantages more widely than was ever possible in practice with the old system under which at any given time only a minority of countries were actually working with free exchanges. In conditions of multilateral clearing, exchange dealings would be carried on as freely as in the best days of the gold standard, without its being necessary to ask anyone to accept special or onerous conditions.

21. The principles governing transactions are: first, that the Clearing Union is set up, not for the transaction of daily business between individual traders or banks, but for the clearing and settlement of the ultimate outstanding balances between Central Banks (and certain other super-national Institutions), such as would have been settled under the old gold standard by the shipment or the earmarking of gold, and should not tresspass unnecessarily beyond this field; and, second, that its purpose is to increase *freedom* in international commerce and not to multiply interferences or compulsions.

22. Many Central Banks have found great advantages in centralising with themselves or with an Exchange Control the supply and demand of all foreign exchange, thus dispensing with an outside exchange market, though continuing to accommodate individuals through the existing banks and not directly. The further extension of such arrangements would be consonant with the general purposes of the Clearing Union, inasmuch as they would promote order and discipline in international exchange transactions in detail as well as in general. The same is true of the control of capital movements, further described below, which many States are likely to wish to impose on their own nationals. But the structure of the proposed Clearing Union does not *require* such measures of centralisation or of control on the part of a member State. It is, for example, consistent alike with the type of Exchange Control now established in the

United Kingdom or with the system now operating in the United States. The Union does not prevent private holdings of foreign currency or private dealings in exchange or international capital movements, if these have been approved or allowed by the member States concerned. Central Banks can deal direct with one another as heretofore. No transaction in bancor will take place except when a member State or its Central Bank is exercising the right to pay in it. In no case is there any direct control on capital movements by the Union, even in the case of 6 (8) (*b*) (ii) above, but only by the member States themselves through their own institutions. Thus the fabric of international banking organisation, built up by long experience to satisfy practical needs, would be left as undisturbed as possible.

23. It is not necessary to interfere with the discretion of countries which desire to maintain a special intimacy within a particular group of countries associated by geographical or political ties, such as the existing sterling area, or groups, like the Latin Union of former days, which may come into existence covering, for example, the countries of North America or those of South America, or the groups now under active discussion, including Poland and Czechoslovakia or certain of the Balkan States. There is no reason why such countries should not be allowed a double position, both as members of the Clearing Union in their own right with their proper quota, and also as making use of another financial centre along traditional lines, as, for example, Australia and India with London, or certain American countries with New York. In this case, their accounts with the Clearing Union would be in exactly the same position as the independent gold reserves which they now maintain, and they would have no occasion to modify in any way their present practices in the conduct of daily business.

24. There might be other cases, however, in which a dependency or a member of a federal union would merge its currency identity in that of a mother country, with a quota appropriately adjusted to the merged currency area as a whole, and *not* enjoy a separate individual membership of the Clearing Union, as, for example, the States of a Federal Union, the French colonies or the British Crown Colonies.

25. At the same time countries, which do not belong to a special geographical or political group, would be expected to keep their reserve balances with the Clearing Union and not with one another. It has, therefore, been laid down that balances may not be held in another country except with the approval of the monetary authorities of that country; and, in order that sterling and dollars might not appear to compete with bancor for the purpose of reserve balances, the United Kingdom and the United States might agree together that they would not accept the reserve balances of other countries in excess of normal working balances except in the case of banks definitely belonging to a Sterling Area or Dollar Area group.

VI. The Position of Gold under the Plan

26. Gold still possesses great psychological value which is not being diminished by current events; and the desire to possess a gold reserve against unforeseen contingencies is likely to remain. Gold also has the merit of providing in point of form (whatever the underlying realities may be) an uncontroversial standard of value for international purposes, for which it would not yet be easy to find a serviceable substitute. Moreover, by supplying an automatic means for settling some part of the favourable balances of the creditor countries, the current gold production of the world and the remnant of gold reserves held outside the United States may still have a useful part to play. Nor is it reasonable to ask the United States to de-monetise the stock of gold which is the basis of its impregnable liquidity. What, in the long run, the world may decide to do with gold is another matter. The purpose of the Clearing Union is to supplant gold as a governing factor, but not to dispense with it.

27. The international bank-money which we have designated *bancor* is defined in terms of a weight of gold. Since the national currencies of the member States are given a defined exchange value in terms of bancor, it follows that they would each have a defined gold content which would be their official buying price for gold, above which they must not pay. The fact that a member State is entitled to obtain a credit in terms of bancor by paying actual gold to the credit of its clearing account, se-

cures a steady and ascertained purchaser for the output of the gold-producing countries, and for countries holding a large reserve of gold. Thus the position of producers and holders of gold is not affected adversely, and is, indeed, improved.

28. Central Banks would be entitled to retain their separate gold reserves and ship gold to one another, provided they did not pay a price above parity; they could coin gold and put it into circulation, and, generally speaking, do what they liked with it.

29. One limitation only would be, for obvious reasons, essential. No member State would be entitled to demand gold from the Clearing Union against its balance of bancor; for bancor is available only for transfer to another clearing account. Thus between gold and bancor itself there would be a one-way convertibility, such as ruled frequently before the war with national currencies which were on what was called a "gold exchange standard." This need not mean that the Clearing Union would only receive gold and never pay it out. It has been provided above that, if the Clearing Union finds itself in possession of a stock of gold, the Governing Board shall have discretion to distribute the surplus between those possessing credit balances in bancor, proportionately to such balances, in reduction of their amount.

30. The question has been raised whether these arrangements are compatible with the retention by individual member States of a full gold standard with two-way convertibility, so that, for example, any foreign central bank acquiring dollars could use them to obtain gold for export. It is not evident that a good purpose would be served by this. But it need not be prohibited, and if any member State should prefer to maintain full convertibility for internal purposes it could protect itself from any abuse of the system or inconvenient consequences by providing that gold could only be exported under licence.

31. The value of bancor in terms of gold is fixed but not unalterably. The power to vary its value might have to be exercised if the stocks of gold tendered to the Union were to be excessive. No object would be served by attempting further to peer into the future or to prophesy the ultimate outcome.

VII. The Control of Capital Movements

32. There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds, which constitute an unwanted import of capital, yet cannot safely be used for fixed investment.

33. For these reasons it is widely held that control of capital movements, both inward and outward, should be a permanent feature of the post-war system. It is an objection to this that control, if it is to be effective, probably requires the machinery of exchange control for *all* transactions, even though a general permission is given to all remittances in respect of current trade. Thus those countries which have for the time being no reason to fear, and may indeed welcome, outward capital movements, may be reluctant to impose this machinery, even though a general permission for capital, as well as current transactions reduces it to being no more than a machinery of record. On the other hand, such control will be more difficult to work by unilateral action on the part of those countries which cannot afford to dispense with it, especially in the absence of a postal censorship, if movements of capital cannot be controlled *at both ends*. It would, therefore, be of great advantage if the United States, as well as other members of the Clearing Union, would adopt machinery similar to that which the British Exchange Control has now gone a long way towards perfecting. Nevertheless, the universal establishment of a control of capital movements cannot be regarded as essential to the operation of the Clearing Union; and the method and degree of such control should therefore be left to the decision of each member State. Some less drastic way might be found by which countries, not themselves controlling outward capital movements can deter inward movements not approved by the countries from which they originate.

34. The position of abnormal balances in overseas ownership held in various countries at the end of the war presents a problem of considerable importance and special difficulty. A country

in which a large volume of such balances is held could not, unless it is in a creditor position, afford the risk of having to redeem them in bancor on a substantial scale, if this would have the effect of depleting its bancor resources at the outset. At the same time, it is very desirable that the countries owning these balances should be able to regard them as liquid, at any rate over and above the amounts which they can afford to lock up under an agreed programme of funding or long-term expenditure. Perhaps there should be some special over-riding provision for dealing with the transitional period only by which, through the aid of the Clearing Union, such balances would remain liquid and convertible into bancor by the creditor country whilst there would be no corresponding strain on the bancor resources of the debtor country, or, at any rate, the resulting strain would be spread over a period.

35. The advocacy of a control of capital movements must not be taken to mean that the era of international investment should be brought to an end. On the contrary, the system contemplated should greatly facilitate the restoration of international loans and credits for legitimate purposes in ways to be discussed below. The object, and it is a vital object, is to have a means—

(*a*) of distinguishing long-term loans by creditor countries, which help to maintain equilibrium and develop the world's resources, from movements of funds out of debtor countries which lack the means to finance them; and

(*b*) of controlling short-term speculative movements or flights of currency whether out of debtor countries or from one creditor country to another.

36. It should be emphasised that the purpose of the overdrafts of bancor permitted by the Clearing Union is, not to facilitate long-term, or even medium-term, credits to be made by debtor countries which cannot afford them, but to allow time and a breathing space for adjustments and for averaging one period with another to all member States alike, whether in the long run they are well-placed to develop a forward international loan policy or whether their prospects of profitable new development in excess of their own resources justifies them in

long-term borrowing. The machinery and organisation of international medium-term and long-term lending is another aspect of post-war economic policy, not less important than the purposes which the Clearing Union seeks to serve, but requiring another, complementary institution.

VIII. Relation of the Clearing Union to Commercial Policy

37. The special protective expedients which were developed between the two wars were sometimes due to political, social or industrial reasons. But frequently they were nothing more than forced and undesired dodges to protect an unbalanced position of a country's overseas payments. The new system, by helping to provide a register of the size and whereabouts of the aggregate debtor and creditor positions respectively, and an indication whether it is reasonable for a particular country to adopt special expedients as a temporary measure to assist in regaining equilibrium in its balance of payments, would make it possible to establish a general rule *not* to adopt them, subject to the indicated exceptions.

38. The existence of the Clearing Union would make it possible for member States contracting commercial agreements to use their respective debit and credit positions with the Clearing Union as a test, though this test by itself would not be complete. Thus, the contracting parties, whilst agreeing to clauses in a commercial agreement forbidding, in general, the use of certain measures or expedients in their mutual trade relations, might make this agreement subject to special relaxations if the state of their respective clearing accounts satisfied an agreed criterion. For example, an agreement might provide that, in the event of one of the contracting States having a debit balance with the Clearing Union exceeding a specified proportion of its quota on the average of a period, it should be free to resort to import regulation to barter trade agreements or to higher import duties of a type which was restricted under the agreement in normal circumstances. Protected by the possibility of such temporary indulgences, the members of the Clearing Union should feel much more confidence in moving towards the withdrawal of other and more dislocating forms of protection and

discrimination and in accepting the prohibition of the worst of them from the outset. In any case, it should be laid down that members of the Union would not allow or suffer among themselves any restrictions on the disposal of receipts arising out of current trade or "invisible" income.

IX. The Use of the Clearing Union for Other International Purposes

39. The Clearing Union might become the instrument and the support of international policies in addition to those which it is its primary purpose to promote. This deserves the greatest possible emphasis. The Union might become the pivot of the future economic government of the world. Without it, other more desirable developments will find themselves impeded and unsupported. With it, they will fall into their place as parts of an ordered scheme. No one of the following suggestions is a necessary part of the plan. But they are illustrations of the additional purposes of high importance and value which the Union, once established, might be able to serve:—

(1) The Union might set up a clearing account in favour of international bodies charged with post-war relief, rehabilitation and reconstruction. But it could go much further than this. For it might supplement contributions received from other sources by granting preliminary overdraft facilities in favour of these bodies, the overdraft being discharged over a period of years out of the Reserve Fund of the Union, or, if necessary, out of a levy on surplus credit balances. So far as this method is adopted it would be possible to avoid asking any country to assume a burdensome commitment for relief and reconstruction, since the resources would be provided in the first instance by those countries having credit clearing accounts for which they have no immediate use and are voluntarily leaving idle, and in the long run by those countries which have a chronic international surplus for which they have no beneficial employment.

(2) The Union might set up an account in favour of any super-national policing body which may be charged with the duty of preserving the peace and maintaining international order. If any country were to infringe its properly authorised

orders, the policing body might be entitled to request the Governors of the Clearing Union to hold the clearing account of the delinquent country to its order and permit no further transactions on the account except by its authority. This would provide an excellent machinery for enforcing a financial blockade.

(3) The Union might set up an account in favour of international bodies charged with the management of a Commodity Control, and might finance stocks of commodities held by such bodies, allowing them overdraft facilities on their accounts up to an agreed maximum. By this means the financial problem of buffer stocks and "ever-normal granaries" could be effectively attacked.

(4) The Union might be linked up with a Board for International Investment. It might act on behalf of such a Board and collect for them the annual service of their loans by automatically debiting the clearing account of the country concerned. The statistics of the clearing accounts of the member States would give a reliable indication as to which countries were in a position to finance the Investment Board, with the advantage of shifting the whole system of clearing credits and debits nearer to equilibrium.

(5) There are various methods by which the Clearing Union could use its influence and its powers to maintain stability of prices and to control the Trade Cycle. If an International Economic Board is established, this Board and the Clearing Union might be expected to work in close collaboration to their mutual advantage. If an International Investment or Development Corporation is also set up together with a scheme of Commodity Controls for the control of stocks of the staple primary products, we might come to possess in these three Institutions a powerful means of combating the evils of the Trade Cycle, by exercising contractionist or expansionist influence on the system as a whole or on particular sections. This is a large and important question which cannot be discussed adequately in this paper; and need not be examined at length in this place because it does not raise any important issues affecting the fundamental constitution of the proposed Union. It is mentioned here to

complete the picture of the wider purposes which the foundation of the Clearing Union might be made to serve.

40. The facility of applying the Clearing Union plan to these several purposes arises out of a fundamental characteristic which is worth pointing out, since it distinguishes the plan from those proposals which try to develop the same basic principle along bilateral lines and is one of the grounds on which the Plan can claim superior merit. This might be described as its "anonymous" or "impersonal" quality. No particular member States have to engage their own resources as such to the support of other particular States or of any of the international projects or policies adopted. They have only to agree in general that, if they find themselves with surplus resources which for the time being they do not themselves wish to employ, these resources may go into the general pool and be put to work on approved purposes. This costs the surplus country nothing because it is not asked to part permanently, or even for any specified period, with such resources, which it remains free to expend and employ for its own purposes whenever it chooses; in which case the burden of finance is passed on to the next recipient, again for only so long as the recipient has no use for the money. As pointed out above, this merely amounts to extending to the international sphere the methods of any domestic banking system, which are in the same sense "impersonal" inasmuch as there is no call on the particular depositor either to support as such the purposes for which his banker makes advances or to forgo permanently the use of his deposit. There is no countervailing objection except that which applies equally to the technique of domestic banking, namely that it is capable of the abuse of creating excessive purchasing power and hence an inflation of prices. In our efforts to avoid the opposite evil, we must not lose sight of this risk, to which there is an allusion in 39 (5) above. But it is no more reason for refusing the advantages of international banking than the similar risk in the domestic field is a reason to return to the practices of the seventeenth century goldsmiths (which are what we are still following in the international field) and to forgo the vast expansion of production which banking principles have made possible. Where

financial contributions are required for some purpose of general advantage it is a great facility not to have to ask for specific contributions from any named country, but to depend rather on the anonymous and impersonal aid of the system as a whole. We have here a genuine organ of truly international government.

X. The Transitional Arrangements

41. It would be of great advantage to agree [to] the general principles of the Clearing Union before the end of the war, with a view to bringing it into operation at an early date after the termination of hostilities. Major plans will be more easily brought to birth in the first energy of victory and whilst the active spirit of united action still persists, than in the days of exhaustion and reaction from so much effort which may well follow a little later. Such a proposal presents, however, something of a dilemma. On the one hand, many countries will be in particular need of reserves of overseas resources in the period immediately after the war. On the other hand, goods will be in short supply and the prevention of inflationary international conditions of much more importance for the time being than the opposite. The expansionist tendency of the plan, which is a leading recommendation of it as soon as peace-time output is restored and the productive capacity of the world is in running order, might be a danger in the early days of a sellers' market and an excess of demand over supply.

42. A reconciliation of these divergent purposes is not easily found until we know more than is known at present about the means to be adopted to finance post-war relief and reconstruction. If the intention is to provide resources on liberal and comprehensive lines outside the resources made available by the Clearing Union and additional to them, it might be better for such specific aid to take the place of the proposed overdrafts during the "relief" period of (say) two years. In this case credit clearing balances would be limited to the amount of gold delivered to the Union, and the overdraft facilities created by the Union in favour of the Relief Council, the International Investment Board or the Commodity Controls. Nevertheless, the im-

mediate establishment of the Clearing Union would not be incompatible with provisional arrangements, which could take alternative forms according to the character of the other "relief" arrangements, qualifying and limiting the overdraft quotas. Overdraft quotas might be allowed on a reduced scale during the transitional period. Or it might be proper to provide that countries in receipt of relief or Lend-Lease assistance should not have access at the same time to overdraft facilities, and that the latter should only become available when the former had come to an end. If, on the other hand, relief from outside sources looks like being inadequate from the outset, the overdraft quotas may be even more necessary at the outset than later on.

43. We must not be over-cautious. A rapid economic restoration may lighten the tasks of the diplomatists and the politicians in the resettlement of the world and the restoration of social order. For Great Britain and other countries outside the "relief" areas the possibility of exports sufficient to sustain their standard of life is bound up with good and expanding markets. We cannot afford to wait too long for this, and we must not allow excessive caution to condemn us to perdition. Unless the Union is a going concern, the problem of proper "timing" will be nearly insoluble. It is sufficient at this stage to point out that the problem of timing must not be overlooked, but that the Union is capable of being used so as to aid rather than impede its solution.

XI. Conclusion

44. It has been suggested that so ambitious a proposal is open to criticism on the ground that it requires from the members of the Union a greater surrender of their sovereign rights than they will readily concede. But no greater surrender is required than in a commercial treaty. The obligations will be entered into voluntarily and can be terminated on certain conditions by giving notice.

45. A greater readiness to accept super-national arrangements must be required in the post-war world. If the arrangements proposed can be described as a measure of financial

disarmament, there is nothing here which we need be reluctant to accept ourselves or to ask of others. It is an advantage, and not a disadvantage, of the scheme that it invites the member States to abandon that licence to promote indiscipline, disorder and bad-neighbourliness which, to the general disadvantage, they have been free to exercise hitherto.

46. The plan makes a beginning at the future economic ordering of the world between nations and "the winning of the peace." It might help to create the conditions and the atmosphere in which much else would be made easier.

APPENDIX III

Joint Statement by Experts on the Establishment of an International Monetary Fund

April 21, 1944

Sufficient discussion of the problems of international monetary cooperation has taken place at the technical level to justify a statement of principles. It is the consensus of opinion of the experts of the United and Associated Nations who have participated in these discussions that the most practical method of assuring international monetary cooperation is through the establishment of an International Monetary Fund. The principles set forth below are designed to constitute the basis for this Fund. Governments are not asked to give final approval to these principles until they have been embodied in the form of definite proposals by the delegates of the United and Associated Nations meeting in a formal conference.

I. Purposes and Policies of the International Monetary Fund

The Fund will be guided in all its decisions by the purposes and policies set forth below:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade and to contribute in this way to the maintenance of a high level of employment and real income, which must be a primary objective of economic policy.
3. To give confidence to member countries by making the Fund's resources available to them under adequate safeguards, thus giving members time to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

4. To promote exchange stability, to maintain orderly exchange arrangements among member countries, and to avoid competitive exchange depreciation.

5. To assist in the establishment of multilateral payments facilities on current transactions among member countries and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

6. To shorten the periods and lessen the degree of disequilibrium in the international balance of payments of member countries.

II. Subscription to the Fund

1. Member countries shall subscribe in gold and in their local funds amounts (quotas) to be agreed, which will amount altogether to about $8 billion if all the United and Associated Nations subscribe to the Fund (corresponding to about $10 billion for the world as a whole).

2. The quotas may be revised from time to time but changes shall require a four-fifths vote and no member's quota may be changed without its assent.

3. The obligatory gold subscription of a member country shall be fixed at 25 percent of its subscription (quota) or 10 percent of its holdings of gold and gold-convertible exchange, whichever is the smaller.

III. Transactions with the Fund

1. Member countries shall deal with the Fund only through their Treasury, Central Bank, Stabilization Fund, or other fiscal agencies. The Fund's account in a member's currency shall be kept at the Central Bank of the member country.

2. A member shall be entitled to buy another member's currency from the Fund in exchange for its own currency on the following conditions:

(*a*) The member represents that the currency demanded is presently needed for making payments in that currency which are consistent with the purposes of the Fund.

(*b*) The Fund has not given notice that its holdings of the

currency demanded have become scarce in which case the provisions of VI, below, come into force.

(*c*) The Fund's total holdings of the currency offered (after having been restored, if below that figure, to 75 percent of the member's quota) have not been increased by more than 25 percent of the member's quota during the previous twelve months and do not exceed 200 percent of the quota.

(*d*) The Fund has not previously given appropriate notice that the member is suspended from making further use of the Fund's resources on the ground that it is using them in a manner contrary to the purposes and policies of the Fund; but the Fund shall not give such notice until it has presented to the member concerned a report setting forth its views and has allowed a suitable time for reply.

The Fund may in its discretion and on terms which safeguard its interests waive any of the conditions above.

3. The operations on the Fund's account will be limited to transactions for the purpose of supplying a member country on the member's initiative with another member's currency in exchange for its own currency or for gold. Transactions provided for under 4 and 7, below, are not subject to this limitation.

4. The Fund will be entitled at its option, with a view to preventing a particular member's currency from becoming scarce:

(*a*) To borrow its currency from a member country;
(*b*) To offer gold to a member country in exchange for its currency.

5. So long as a member country is entitled to buy another member's currency from the Fund in exchange for its own currency, it shall be prepared to buy its own currency from that member with that member's currency or with gold. This shall not apply to currency subject to restrictions in conformity with IX, 3 below, or to holdings of currency which have accumulated as a result of transactions of a current account nature

effected before the removal by the member country of restrictions on multilateral clearing maintained or imposed under X, 2 below.

6. A member country desiring to obtain, directly or indirectly, the currency of another member country for gold is expected, provided that it can do so with equal advantage, to acquire the currency by the sale of gold to the Fund. This shall not preclude the sale of newly-mined gold by a gold-producing country on any market.

7. The Fund may also acquire gold from member countries in accordance with the following provisions:

(*a*) A member country may repurchase from the Fund for gold any part of the latter's holdings of its currency.

(*b*) So long as a member's holdings of gold and gold-convertible exchange exceed its quota, the Fund in selling foreign exchange to that country shall require that one-half of the net sales of such exchange during the Fund's financial year be paid for with gold.

(*c*) If at the end of the Fund's financial year a member's holdings of gold and gold-convertible exchange have increased, the Fund may require up to one-half of the increase to be used to repurchase part of the Fund's holdings of its currency so long as this does not reduce the Fund's holdings of a country's currency below 75 percent of its quota or the member's holdings of gold and gold-convertible exchange below its quota.

IV. Par Values of Member Currencies

1. The par value of a member's currency shall be agreed with the Fund when it is admitted to membership, and shall be expressed in terms of gold. All transactions between the Fund and members shall be at par, subject to a fixed charge payable by the member making application to the Fund, and all transactions in member currencies shall be at rates within an agreed percentage of parity.

2. Subject to 5, below, no change in the par value of a member's currency shall be made by the Fund without the coun-

try's approval. Member countries agree not to propose a change in the parity of their currency unless they consider it appropriate to the correction of a fundamental disequilibrium. Changes shall be made only with the approval of the Fund, subject to the provisions below.

3. The Fund shall approve a requested change in the par value of a member's currency, if it is essential to the correction of a fundamental disequilibrium. In particular, the Fund shall not reject a requested change, necessary to restore equilibrium, because of the domestic social or political policies of the country applying for a change. In considering a requested change, the Fund shall take into consideration the extreme uncertainties prevailing at the time the parities of the currencies of the member countries were initially agreed upon.

4. After consulting the Fund, a member country may change the established parity of its currency, provided the proposed change, inclusive of any previous change since the establishment of the Fund, does not exceed 10 percent. In the case of application for a further change, not covered by the above and not exceeding 10 percent, the Fund shall give its decision within two days of receiving the application, if the applicant so requests.

5. An agreed uniform change may be made in the gold value of member currencies, provided every member country having 10 percent or more of the aggregate quotas approves.

V. Capital Transactions

1. A member country may not use the Fund's resources to meet a large or sustained outflow of capital, and the Fund may require a member country to exercise controls to prevent such use of the resources of the Fund. This provision is not intended to prevent the use of the Fund's resources for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking or other business. Nor is it intended to prevent capital movements which are met out of a member country's own resources of gold and foreign exchange, provided such capital movements are in accordance with the purposes of the Fund.

2. Subject to VI below, a member country may not use its control of capital movements to restrict payments for current transactions or to delay unduly the transfer of funds in settlement of commitments.

VI. Apportionment of Scarce Currencies

1. When it becomes evident to the Fund that the demand for a member country's currency may soon exhaust the Fund's holdings of that currency, the Fund shall so inform member countries and propose an equitable method of apportioning the scarce currency. When a currency is thus declared scarce, the Fund shall issue a report embodying the causes of the scarcity and containing recommendations designed to bring it to an end.

2. A decision by the Fund to apportion a scarce currency shall operate as an authorization to a member country, after consultation with the Fund, temporarily to restrict the freedom of exchange operations in the affected currency, and in determining the manner of restricting the demand and rationing the limited supply among its nationals, the member country shall have complete jurisdiction.

VII. Management

1. The Fund shall be governed by a board on which each member will be represented and by an executive committee. The executive committee shall consist of at least nine members including the representatives of the five countries with the largest quotas.

2. The distribution of voting power on the board and the executive committee shall be closely related to the quotas.

3. Subject to II, 2 and IV, 5, all matters shall be settled by a majority of the votes.

4. The Fund shall publish at short intervals a statement of its position showing the extent of its holdings of member currencies and of gold and its transactions in gold.

VIII. Withdrawal

1. A member country may withdraw from the Fund by giving notice in writing.

2. The reciprocal obligations of the Fund and the country are to be liquidated within a reasonable time.

3. After a member country has given notice in writing of its withdrawal from the Fund, the Fund may not dispose of its holdings of the country's currency except in accordance with the arrangements made under 2, above. After a country has given notice of withdrawal, its use of the resources of the Fund is subject to the approval of the Fund.

IX. The Obligations of Member Countries

1. Not to buy gold at a price which exceeds the agreed parity of its currency by more than a prescribed margin and not to sell gold at a price which falls below the agreed parity by more than a prescribed margin.

2. Not to allow exchange transactions in its market in currencies of other members at rates outside a prescribed range based on the agreed parities.

3. Not to impose restrictions on payments for current international transactions with other member countries (other than those involving capital transfers or in accordance with VI, above) or to engage in any discriminatory currency arrangements or multiple currency practices without the approval of the Fund.

X. Transitional Arrangements

1. Since the Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of the war, the agreement of a member country to provisions III, 5 and IX, 3 above, shall not become operative until it is satisfied as to the arrangements at its disposal to facilitate the settlement of the balance of payments differences during the early post-war transition period by means which will not unduly encumber its facilities with the Fund.

2. During this transition period member countries may main-

tain and adapt to changing circumstances exchange regulations of the character which have been in operation during the war, but they shall undertake to withdraw as soon as possible by progressive stages any restrictions which impede multilateral clearing on current account. In their exchange policy they shall pay continuous regard to the principles and objectives of the Fund; and they shall take all possible measures to develop commercial and financial relations with other member countries which will facilitate international payments and the maintenance of exchange stability.

3. The Fund may make representations to any member that conditions are favorable to withdrawal of particular restrictions or for the general abandonment of the restrictions inconsistent with IX, 3 above. Not later than three years after coming into force of the Fund any member still retaining any restrictions inconsistent with IX, 3, shall consult with the Fund as to their further retention.

4. In its relations with member countries, the Fund shall recognize that the transition period is one of change and adjustment, and in deciding on its attitude to any proposals presented by members it shall give the member country the benefit of any reasonable doubt.

APPENDIX IV

Articles of Agreement

INTERNATIONAL MONETARY FUND

United Nations Monetary and Financial Conference
Bretton Woods, N. H., July 1 to 22, 1944

SCHEDULES

Articles of Agreement

INTERNATIONAL MONETARY FUND

The Governments on whose behalf the present Agreement is signed agree as follows:

Introductory Article

The International Monetary Fund is established and shall operate in accordance with the following provisions:

Article I. Purposes

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its decisions by the purposes set forth in this Article.

Article II. Membership

SECTION 1. *Original members.*—The original members of the Fund shall be those of the countries represented at the United Nations Monetary and Financial Conference whose governments accept membership before the date specified in Article XX, Section 2 (*e*).

SEC. 2. *Other members.*—Membership shall be open to the governments of other countries at such times and in accordance with such terms as may be prescribed by the Fund.

Article III. Quotas and Subscriptions

SECTION 1. *Quotas.*—Each member shall be assigned a quota. The quotas of the members represented at the United Nations Monetary and Financial Conference which accept membership before the date specified in Article XX, Section 2 (*e*), shall be those set forth in Schedule A. The quotas of other members shall be determined by the Fund.

SEC. 2. *Adjustment of quotas.*—The Fund shall at intervals of five years review, and if it deems it appropriate propose an adjustment of, the quotas of the members. It may also, if it thinks fit, consider at any other time the adjustment of any particular quota at the request of the member concerned. A four-fifths majority of the total voting power shall be required for any change in quotas and no quota shall be changed without the consent of the member concerned.

SEC. 3. *Subscriptions: Time, place, and form of payment.*—(*a*) The subscription of each member shall be equal to its quota and shall be paid in full to the Fund at the appropriate depository on or before the date when the member becomes eligible under Article XX, Section 4 (*c*) or (*d*), to buy currencies from the Fund.

(*b*) Each member shall pay in gold, as a minimum, the smaller of

(i) twenty-five percent of its quota; or
(ii) ten percent of its net official holdings of gold and United States dollars as at the date when the Fund notifies members under Article XX, Section 4 (*a*) that it will shortly be in a position to begin exchange transactions.

Each member shall furnish to the Fund the data necessary to determine its net official holdings of gold and United States dollars.

(*c*) Each member shall pay the balance of its quota in its own currency.

(*d*) If the net official holdings of gold and United States dollars of any member as at the date referred to in (*b*) (ii) above are not ascertainable because its territories have been occupied by the enemy, the Fund shall fix an appropriate alternative date for determining such holdings. If such date is later than that on which the country becomes eligible under Article XX, Section 4 (*c*) or (*d*), to buy currencies from the Fund, the Fund and the member shall agree on a provisional gold payment to be made under (*b*) above, and the balance of the member's subscription shall be paid in the member's currency, subject to appropriate adjustment between the member and the Fund when the net official holdings have been ascertained.

SEC. 4. *Payments when quotas are changed.*—(*a*) Each member which consents to an increase in its quota shall, within thirty days after the date of its consent, pay to the Fund twenty-five percent of the increase in gold and the balance in its own currency. If, however, on the date when the member consents to an increase, its monetary reserves are less than its new quota, the Fund may reduce the proportion of the increase to be paid in gold.

(*b*) If a member consents to a reduction in its quota, the Fund shall, within thirty days after the date of the consent, pay to the member an amount equal to the reduction. The payment shall be made in the member's currency and in such

amount of gold as may be necessary to prevent reducing the Fund's holdings of the currency below seventy-five percent of the new quota.

SEC. 5. *Substitution of securities for currency.*—The Fund shall accept from any member in place of any part of the member's currency which in the judgment of the Fund is not needed for its operations, notes or similar obligations issued by the member or the depository designated by the member under Article XIII, Section 2, which shall be non-negotiable, non-interest bearing and payable at their par value on demand by crediting the account of the Fund in the designated depository. This Section shall apply not only to currency subscribed by members but also to any currency otherwise due to, or acquired by, the Fund.

Article IV. Par Values of Currencies

SECTION 1. *Expression of par values.*—(*a*) The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.

(*b*) All computations relating to currencies of members for the purpose of applying the provisions of this Agreement shall be on the basis of their par values.

SEC. 2. *Gold purchases based on par values.*—The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin.

SEC. 3. *Foreign exchange dealings based on parity.*—The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity.

(i) in the case of spot exchange transactions, by more than one percent; and

(ii) in the case of other exchange transactions, by a margin which exceeds the margin for spot exchange transactions by more than the Fund considers reasonable.

SEC. 4. *Obligations regarding exchange stability.*—(*a*) Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations.

(*b*) Each member undertakes, through appropriate measures consistent with this Agreement, to permit within its territories exchange transactions between its currency and the currencies of other members only within the limits prescribed under Section 3 of this Article. A member whose monetary authorities, for the settlement of international transactions, in fact freely buy and sell gold within the limits prescribed by the Fund under Section 2 of this Article shall be deemed to be fulfilling this undertaking.

SEC. 5. *Changes in par values.*—(*a*) A member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium.

(*b*) A change in the par value of a member's currency may be made only on the proposal of the member and only after consultation with the Fund.

(*c*) When a change is proposed, the Fund shall first take into account the changes, if any, which have already taken place in the initial par value of the member's currency as determined under Article XX, Section 4. If the proposed change, together with all previous changes, whether increases or decreases,

(i) does not exceed ten percent of the initial par value, the Fund shall raise no objection;

(ii) does not exceed a further ten percent of the initial par value, the Fund may either concur or object, but shall declare its attitude within seventy-two hours if the member so requests;

(iii) is not within (i) or (ii) above, the Fund may either concur or object, but shall be entitled to a longer period in which to declare its attitude.

(*d*) Uniform changes in par values made under Section 7 of this Article shall not be taken into account in determining

whether a proposed change falls within (i), (ii), or (iii) of (*c*) above.

(*e*) A member may change the par value of its currency without the concurrence of the Fund if the change does not affect the international transactions of members of the Fund.

(*f*) The Fund shall concur in a proposed change which is within the terms of (*c*) (ii) or (*c*) (iii) above if it is satisfied that the change is necessary to correct a fundamental disequilibrium. In particular, provided it is so satisfied, it shall not object to a proposed change because of the domestic social or political policies of the member proposing the change.

SEC. 6. *Effect of unauthorized changes.*—If a member changes the par value of its currency despite the objection of the Fund, in cases where the Fund is entitled to object, the member shall be ineligible to use the resources of the Fund unless the Fund otherwise determines; and if, after the expiration of a reasonable period, the difference between the member and the Fund continues, the matter shall be subject to the provisions of Article XV, Section 2 (*b*).

SEC. 7. *Uniform changes in par values.*—Notwithstanding the provisions of Section 5 (*b*) of this Article, the Fund by a majority of the total voting power may make uniform proportionate changes in the par values of the currencies of all members, provided each such change is approved by every member which has ten percent or more of the total of the quotas. The par value of a member's currency shall, however, not be changed under this provision if, within seventy-two hours of the Fund's action, the member informs the Fund that it does not wish the par value of its currency to be changed by such action.

SEC. 8. *Maintenance of gold value of the Fund's assets.*—(*a*) The gold value of the Fund's assets shall be maintained notwithstanding changes in the par or foreign exchange value of the currency of any member.

(*b*) Whenever (i) the par value of a member's currency is reduced, or (ii) the foreign exchange value of a member's currency has, in the opinion of the Fund, depreciated to a significant extent within that member's territories, the member shall pay to the Fund within a reasonable time an amount of

its own currency equal to the reduction in the gold value of its currency held by the Fund.

(*c*) Whenever the par value of a member's currency is increased, the Fund shall return to such member within a reasonable time an amount in its currency equal to the increase in the gold value of its currency held by the Fund.

(*d*) The provisions of this Section shall apply to a uniform proportionate change in the par values of the currencies of all members, unless at the time when such a change is proposed the Fund decides otherwise.

SEC. 9. *Separate currencies within a member's territories.*—A member proposing a change in the par value of its currency shall be deemed, unless it declares otherwise, to be proposing a corresponding change in the par value of the separate currencies of all territories in respect of which it has accepted this Agreement under Article XX, Section 2 (*g*). It shall, however, be open to a member to declare that its proposal relates either to the metropolitan currency alone, or only to one or more specified separate currencies, or to the metropolitan currency and one or more specified separate currencies.

Article V. Transactions with the Fund

SECTION 1. *Agencies dealing with the Fund.*—Each member shall deal with the Fund only through its Treasury, central bank, stabilization fund, or other similar fiscal agency and the Fund shall deal only with or through the same agencies.

SEC. 2. *Limitation on the Fund's operations.*—Except as otherwise provided in this Agreement, operations on the account of the Fund shall be limited to transactions for the purpose of supplying a member, on the initiative of such member, with the currency of another member in exchange for gold or for the currency of the member desiring to make the purchase.

SEC. 3. *Conditions governing use of the Fund's resources.*—(*a*) A member shall be entitled to buy the currency of another member from the Fund in exchange for its own currency subject to the following conditions:

(i) The member desiring to purchase the currency represents that it is presently needed for making in that cur-

rency payments which are consistent with the provisions of this Agreement;

(ii) The Fund has not given notice under Article VII, Section 3, that its holdings of the currency desired have become scarce;

(iii) The proposed purchase would not cause the Fund's holdings of the purchasing member's currency to increase by more than twenty-five percent of its quota during the period of twelve months ending on the date of the purchase nor to exceed two hundred percent of its quota, but the twenty-five percent limitation shall apply only to the extent that the Fund's holdings of the member's currency have been brought above seventy-five percent of its quota if they had been below that amount;

(iv) The Fund has not previously declared under Section 5 of this Article, Article IV, Section 6, Article VI, Section 1, or Article XV, Section 2 (*a*), that the member desiring to purchase is ineligible to use the resources of the Fund.

(*b*) A member shall not be entitled without the permission of the Fund to use the Fund's resources to acquire currency to hold against forward exchange transactions.

SEC. 4. *Waiver of conditions.*—The Fund may in its discretion, and on terms which safeguard its interests, waive any of the conditions prescribed in Section 3 (*a*) of this Article, especially in the case of members with a record of avoiding large or continuous use of the Fund's resources. In making a waiver it shall take into consideration periodic or exceptional requirements of the member requesting the waiver. The Fund shall also take into consideration a member's willingness to pledge as collateral security gold, silver, securities, or other acceptable assets having a value sufficient in the opinion of the Fund to protect its interests and may require as a condition of waiver the pledge of such collateral security.

SEC. 5. *Ineligibility to use the Fund's resources.*—Whenever the Fund is of the opinion that any member is using the resources of the Fund in a manner contrary to the purposes of the Fund, it shall present to the member a report setting forth

the views of the Fund and prescribing a suitable time for reply. After presenting such a report to a member, the Fund may limit the use of its resources by the member. If no reply to the report is received from the member within the prescribed time, or if the reply received is unsatisfactory, the Fund may continue to limit the member's use of the Fund's resources or may, after giving reasonable notice to the member, declare it ineligible to use the resources of the Fund.

SEC. 6. *Purchases of currencies from the Fund for gold.*—(*a*) Any member desiring to obtain, directly or indirectly, the currency of another member for gold shall, provided that it can do so with equal advantage, acquire it by the sale of gold to the Fund.

(*b*) Nothing in this Section shall be deemed to preclude any member from selling in any market gold newly produced from mines located within its territories.

SEC. 7. *Repurchase by a member of its currency held by the Fund.*—(*a*) A member may repurchase from the Fund and the Fund shall sell for gold any part of the Fund's holdings of its currency in excess of its quota.

(*b*) At the end of each financial year of the Fund, a member shall repurchase from the Fund with gold or convertible currencies, as determined in accordance with Schedule B, part of the Fund's holdings of its currency under the following conditions:

(i) Each member shall use in repurchases of its own currency from the Fund an amount of its monetary reserves equal in value to one-half of any increase that has occurred during the year in the Fund's holdings of its currency plus one-half of any increase, or minus one-half of any decrease, that has occurred during the year in the member's monetary reserves. This rule shall not apply when a member's monetary reserves have decreased during the year by more than the Fund's holdings of its currency have increased.

(ii) If after the repurchase described in (i) above (if required) has been made, a member's holdings of another member's currency (or of gold acquired from that mem-

ber) are found to have increased by reason of transactions in terms of that currency with other members or persons in their territories, the member whose holdings of such currency (or gold) have thus increased shall use the increase to repurchase its own currency from the Fund.

(*c*) None of the adjustments described in (*b*) above shall be carried to a point at which

(i) the member's monetary reserves are below its quota, or
(ii) the Fund's holdings of its currency are below seventy-five percent of its quota, or
(iii) the Fund's holdings of any currency required to be used are above seventy-five percent of the quota of the member concerned.

SEC. 8. *Charges.*—(*a*) Any member buying the currency of another member from the Fund in exchange for its own currency shall pay a service charge uniform for all members of three-fourths percent in addition to the parity price. The Fund in its discretion may increase this service charge to not more than one percent or reduce it to not less than one-half percent.

(*b*) The Fund may levy a reasonable handling charge on any member buying gold from the Fund or selling gold to the Fund.

(*c*) The Fund shall levy charges uniform for all members which shall be payable by any member on the average daily balances of its currency held by the Fund in excess of its quota. These charges shall be at the following rates:

(i) *On amounts not more than twenty-five percent in excess of the quota:* no charge for the first three months; one-half percent per annum for the next nine months; and thereafter an increase in the charge of one-half percent for each subsequent year.
(ii) *On amounts more than twenty-five percent and not more than fifty percent in excess of the quota:* an additional one-half percent for the first year; and an additional one-half percent for each subsequent year.

(iii) *On each additional bracket of twenty-five percent in excess of the quota:* an additional one-half percent for the first year; and an additional one-half percent for each subsequent year.

(*d*) Whenever the Fund's holdings of a member's currency are such that the charge applicable to any bracket for any period has reached the rate of four percent per annum, the Fund and the member shall consider means by which the Fund's holdings of the currency can be reduced. Thereafter, the charges shall rise in accordance with the provisions of (*c*) above until they reach five percent and failing agreement, the Fund may then impose such charges as it deems appropriate.

(*e*) The rates referred to in (*c*) and (*d*) above may be changed by a three-fourths majority of the total voting power.

(*f*) All charges shall be paid in gold. If, however, the member's monetary reserves are less than one-half of its quota, it shall pay in gold only that proportion of the charges due which such reserves bear to one-half of its quota, and shall pay the balance in its own currency.

Article VI. Capital Transfers

SECTION 1. *Use of the Fund's resources for capital transfers.* —(*a*) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

(*b*) Nothing in this Section shall be deemed

(i) to prevent the use of the resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking or other business, or

(ii) to affect capital movements which are met out of a member's own resources of gold and foreign exchange, but members undertake that such capital movements will be in accordance with the purposes of the Fund.

SEC. 2. *Special provisions for capital transfers.*—If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2 (*a*), shall be entitled, notwithstanding the provisions of Section 1 (*a*) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired.

SEC. 3. *Controls of capital transfers.*—Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3 (*b*), and in Article XIV, Section 2.

Article VII. Scarce Currencies

SECTION 1. *General scarcity of currency.*—If the Fund finds that a general scarcity of a particular currency is developing, the Fund may so inform members and may issue a report setting forth the causes of the scarcity and containing recommendations designed to bring it to an end. A representative of the member whose currency is involved shall participate in the preparation of the report.

SEC. 2. *Measures to replenish the Fund's holdings of scarce currencies.*—The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency, take either or both of the following steps:

(i) Propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the approval of the member, the Fund borrow such currency from some other source either within or outside the territories of the member, but no member shall be under any obligation to make such loans to the Fund or to approve the borrowing of its currency by the Fund from any other source.

(ii) Require the member to sell its currency to the Fund for gold.

SEC. 3. *Scarcity of the Fund's holdings.*—(*a*) If it becomes evident to the Fund that the demand for a member's currency seriously threatens the Fund's ability to supply that currency, the Fund, whether or not it has issued a report under Section 1 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action.

(*b*) A formal declaration under (*a*) above shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange operations in the scarce currency. Subject to the provisions of Article IV, Sections 3 and 4, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question; and they shall be relaxed and removed as rapidly as conditions permit.

(*c*) The authorization under (*b*) above shall expire whenever the Fund formally declares the currency in question to be no longer scarce.

SEC. 4. *Administration of restrictions.*—Any member imposing restrictions in respect of the currency of any other member pursuant to the provisions of Section 3 (*b*) of this Article shall

give sympathetic consideration to any representations by the other member regarding the administration of such restrictions.

SEC. 5. *Effect of other international agreements on restrictions.*—Members agree not to invoke the obligations of any engagements entered into with other members prior to this Agreement in such a manner as will prevent the operation of the provisions of this Article.

Article VIII. General Obligations of Members

SECTION 1. *Introduction.*—In addition to the obligations assumed under other articles of this Agreement, each member undertakes the obligations set out in this Article.

SEC. 2. *Avoidance of restrictions on current payments.*—(*a*) Subject to the provisions of Article VII, Section 3 (*b*), and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

(*b*) Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, co-operate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

SEC. 3. *Avoidance of discriminatory currency practices.*—No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1, to engage in, any discriminatory currency arrangements or multiple currency practices except as authorized under this Agreement or approved by the Fund. If such arrangements and practices are engaged in at the date when this Agreement enters into force the member concerned shall consult with the Fund as to their progressive removal unless they are maintained or imposed under Article XIV, Section 2, in which case the provisions of Section 4 of that Article shall apply.

SEC. 4. *Convertibility of foreign-held balances.*—(*a*) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents

(i) that the balances to be bought have been recently acquired as a result of current transactions; or
(ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in the currency of the member making the request or in gold.

(*b*) The obligation in (*a*) above shall not apply

(i) when the convertibility of the balances has been restricted consistently with Section 2 of this Article, or Article VI, Section 3; or
(ii) when the balances have accumulated as a result of transactions effected before the removal by a member of restrictions maintained or imposed under Article XIV, Section 2; or
(iii) when the balances have been acquired contrary to the exchange regulations of the member which is asked to buy them; or
(iv) when the currency of the member requesting the purchase has been declared scarce under Article VII, Section 3 (*a*); or
(v) when the member requested to make the purchase is for any reason not entitled to buy currencies of other members from the Fund for its own currency.

SEC. 5. *Furnishing of information.*—(*a*) The Fund may require members to furnish it with such information as it deems necessary for its operations, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on the following matters:

(i) Official holdings at home and abroad, of (1) gold, (2) foreign exchange.
(ii) Holdings at home and abroad by banking and financial agencies, other than official agencies, of (1) gold, (2) foreign exchange.

(iii) Production of gold.

(iv) Gold exports and imports according to countries of destination and origin.

(v) Total exports and imports of merchandise, in terms of local currency values, according to countries of destination and origin.

(vi) International balance of payments, including (1) trade in goods and services, (2) gold transactions, (3) known capital transactions, and (4) other items.

(vii) International investment position, *i.e.*, investments within the territories of the member owned abroad and investments abroad owned by persons in its territories so far as it is possible to furnish this information.

(viii) National income.

(ix) Price indices, i.e., indices of commodity prices in wholesale and retail markets and of export and import prices.

(x) Buying and selling rates for foreign currencies.

(xi) Exchange controls, i.e., a comprehensive statement of exchange controls in effect at the time of assuming membership in the Fund and details of subsequent changes as they occur.

(xii) Where official clearing arrangements exist, details of amounts awaiting clearance in respect of commercial and financial transactions, and of the length of time during which such arrears have been outstanding.

(*b*) In requesting information the Fund shall take into consideration the varying ability of members to furnish the data requested. Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed. Members undertake, however, to furnish the desired information in as detailed and accurate a manner as is practicable, and, so far as possible, to avoid mere estimates.

(*c*) The Fund may arrange to obtain further information by agreement with members. It shall act as a centre for the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies de-

signed to assist members in developing policies which further the purposes of the Fund.

SEC. 6. *Consultation between members regarding existing international agreements.*—Where under this Agreement a member is authorized in the special or temporary circumstances specified in the Agreement to maintain or establish restrictions on exchange transactions, and there are other engagements between members entered into prior to this Agreement which conflict with the application of such restrictions, the parties to such engagements will consult with one another with a view to making such mutually acceptable adjustments as may be necessary. The provisions of this Article shall be without prejudice to the operation of Article VII, Section 5.

Article IX. Status, Immunities and Privileges

SECTION 1. *Purpose of Article.*—To enable the Fund to fulfill the functions with which it is entrusted, the status, immunities and privileges set forth in this Article shall be accorded to the Fund in the territories of each member.

SEC. 2. *Status of the Fund.*—The Fund shall possess full juridical personality, and, in particular, the capacity

(i) to contract;
(ii) to acquire and dispose of immovable and movable property;
(iii) to institute legal proceedings.

SEC. 3. *Immunity from judicial process.*—The Fund, its property and its assets, wherever located and by whomsoever held, shall enjoy immunity from every form of judicial process except to the extent that it expressly waives its immunity for the purpose of any proceedings or by the terms of any contract.

SEC. 4. *Immunity from other action.*—Property and assets of the Fund, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation or any other form of seizure by executive or legislative action.

SEC. 5. *Immunity of archives.*—The archives of the Fund shall be inviolable.

SEC. 6. *Freedom of assets from restrictions.*—To the extent necessary to carry out the operations provided for in this Agreement, all property and assets of the Fund shall be free from restrictions, regulations, controls and moratoria of any nature.

SEC. 7. *Privilege for communications.*—The official communications of the Fund shall be accorded by members the same treatment as the official communications of other members.

SEC. 8. *Immunities and privileges of officers and employees.*—All governors, executive directors, alternates, officers and employees of the Fund

(i) shall be immune from legal process with respect to acts performed by them in their official capacity except when the Fund waives this immunity;

(ii) not being local nationals, shall be granted the same immunities from immigration restrictions, alien registration requirements and national service obligations and the same facilities as regards exchange restrictions as are accorded by members to the representatives, officials, and employees of comparable rank of other members;

(iii) shall be granted the same treatment in respect of traveling facilities as is accorded by members to representatives, officials and employees of comparable rank of other members.

SEC. 9. *Immunities from taxation.*—(*a*) The Fund, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation and from all customs duties. The Fund shall also be immune from liability for the collection or payment of any tax or duty.

(*b*) No tax shall be levied on or in respect of salaries and emoluments paid by the Fund to executive directors, alternates, officers or employees of the Fund who are not local citizens, local subjects, or other local nationals.

(*c*) No taxation of any kind shall be levied on any obligation or security issued by the Fund, including any dividend or interest thereon, by whomsoever held

(i) which discriminates against such obligation or security solely because of its origin; or

(ii) If the sole jurisdictional basis for such taxation is the place or currency in which it is issued, made payable or paid, or the location of any office or place of business maintained by the Fund.

SEC. 10. *Application of Article.*—Each member shall take such action as is necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in this Article and shall inform the Fund of the detailed action which it has taken.

Article X. Relations with Other International Organizations

The Fund shall cooperate within the terms of this Agreement with any general international organization and with public international organizations having specialized responsibilities in related fields. Any arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article XVII.

Article XI. Relations with Non-member Countries

SECTION 1. *Undertakings regarding relations with non-member countries.*—Each member undertakes:

(i) Not to engage in, nor to permit any of its fiscal agencies referred to in Article V, Section 1, to engage in, any transactions with a non-member or with persons in a non-member's territories which would be contrary to the provisions of this Agreement or the purposes of the Fund;

(ii) Not to cooperate with a non-member or with persons in a non-member's territories in practices which would be contrary to the provisions of this Agreement or the purposes of the Fund; and

(iii) To cooperate with the Fund with a view to the application in its territories of appropriate measures to prevent transactions with non-members or with persons in their territories which would be contrary to the provisions of this Agreement or the purposes of the Fund.

SEC. 2. *Restrictions on transactions with non-member countries.*—Nothing in this Agreement shall affect the right of any member to impose restrictions on exchange transactions with non-members or with persons in their territories unless the Fund finds that such restrictions prejudice the interests of members and are contrary to the purposes of the Fund.

Article XII. Organization and Management

SECTION 1. *Structure of the Fund.*—The Fund shall have a Board of Governors, Executive Directors, a Managing Director, and a staff.

SEC. 2. *Board of Governors.*—(*a*) All powers of the Fund shall be vested in the Board of Governors, consisting of one governor and one alternate appointed by each member in such manner as it may determine. Each governor and each alternate shall serve for five years, subject to the pleasure of the member appointing him, and may be reappointed. No alternate may vote except in the absence of his principal. The Board shall select one of the governors as chairman.

(*b*) The Board of Governors may delegate to the Executive Directors authority to exercise any powers of the Board, except the power to:

(i) Admit new members and determine the conditions of their admission.
(ii) Approve a revision of quotas.
(iii) Approve a uniform change in the par value of the currencies of all members.
(iv) Make arrangements to cooperate with other international organizations (other than informal arrangements of a temporary or administrative character).
(v) Determine the distribution of the net income of the Fund.
(vi) Require a member to withdraw.
(vii) Decide to liquidate the Fund.
(viii) Decide appeals from interpretations of this agreement given by the Executive Directors.

(*c*) The Board of Governors shall hold an annual meeting and such other meetings as may be provided for by the Board or called by the Executive Directors. Meetings of the Board shall be called by the Directors whenever requested by five members or by members having one-quarter of the total voting power.

(*d*) A quorum for any meeting of the Board of Governors shall be a majority of the governors exercising not less than two-thirds of the total voting power.

(*e*) Each governor shall be entitled to cast the number of votes allotted under Section 5 of this Article to the member appointing him.

(*f*) The Board of Governors may by regulation establish a procedure whereby the Executive Directors, when they deem such action to be in the best interests of the Fund, may obtain a vote of the governors on a specific question without calling a meeting of the Board.

(*g*) The Board of Governors, and the Executive Directors to the extent authorized, may adopt such rules and regulations as may be necessary or appropriate to conduct the business of the Fund.

(*h*) Governors and alternates shall serve as such without compensation from the Fund, but the Fund shall pay them reasonable expenses incurred in attending meetings.

(*i*) The Board of Governors shall determine the remuneration to be paid to the Executive Directors and the salary and terms of the contract of service of the Managing Director.

SEC. 3. *Executive Directors.*—(*a*) The Executive Directors shall be responsible for the conduct of the general operations of the Fund, and for this purpose shall exercise all the powers delegated to them by the Board of Governors.

(*b*) There shall be not less than twelve directors who need not be governors, and of whom

(i) five shall be appointed by the five members having the largest quotas;

(ii) not more than two shall be appointed when the provisions of (*c*) below apply;

(iii) five shall be elected by the members not entitled to appoint directors, other than the American Republics; and

(iv) two shall be elected by the American Republics not entitled to appoint directors.

For the purposes of this paragraph, members means governments of countries whose names are set forth in Schedule A, whether they become members in accordance with Article XX or in accordance with Article II, Section 2. When governments of other countries become members, the Board of Governors may, by a four-fifths majority of the total voting power, increase the number of directors to be elected.

(*c*) If, at the second regular election of directors and thereafter, the members entitled to appoint directors under (*b*) (i) above do not include the two members, the holdings of whose currencies by the fund have been, on the average over the preceding two years, reduced below their quotas by the largest absolute amounts in terms of gold as a common denominator, either one or both of such members, as the case may be, shall be entitled to appoint a director.

(*d*) Subject to Article XX, Section 3 (*b*) elections of elective directors shall be conducted at intervals of two years in accordance with the provisions of Schedule C, supplemented by such regulations as the Fund deems appropriate. Whenever the Board of Governors increases the number of directors to be elected under (*b*) above, it shall issue regulations making appropriate changes in the proportion of votes required to elect directors under the provisions of Schedule C.

(*e*) Each director shall appoint an alternate with full power to act for him when he is not present. When the directors appointing them are present, alternates may participate in meetings but may not vote.

(*f*) Directors shall continue in office until their successors are appointed or elected. If the office of an elected director becomes vacant more than ninety days before the end of his term, another director shall be elected for the remainder of the

term by the members who elected the former director. A majority of the votes cast shall be required for election. While the office remains vacant, the alternate of the former director shall exercise his powers, except that of appointing an alternate.

(*g*) The Executive Directors shall function in continuous session at the principal office of the Fund and shall meet as often as the business of the Fund may require.

(*h*) A quorum for any meeting of the Executive Directors shall be a majority of the directors representing not less than one-half of the voting power.

(*i*) Each appointed director shall be entitled to cast the number of votes allotted under Section 5 of this Article to the member appointing him. Each elected director shall be entitled to cast the number of votes which counted towards his election. When the provisions of Section 5 (*b*) of this Article are applicable, the votes which a director would otherwise be entitled to cast shall be increased or decreased correspondingly. All the votes which a director is entitled to cast shall be cast as a unit.

(*j*) The Board of Governors shall adopt regulations under which a member not entitled to appoint a director under (*b*) above may send a representative to attend any meeting of the Executive Directors when a request made by, or a matter particularly affecting, that member is under consideration.

(*k*) The Executive Directors may appoint such committees as they deem advisable. Membership of committees need not be limited to governors or directors or their alternates.

SEC. 4. *Managing Director and staff.*—(*a*) The Executive Directors shall select a Managing Director who shall not be a governor or an executive director. The Managing Director shall be chairman of the Executive Directors, but shall have no vote except a deciding vote in case of an equal division. He may participate in meetings of the Board of Governors, but shall not vote at such meetings. The Managing Director shall cease to hold office when the Executive Directors so decide.

(*b*) The Managing Director shall be chief of the operating staff of the Fund and shall conduct, under the direction of the Executive Directors, the ordinary business of the Fund. Subject

to the general control of the Executive Directors, he shall be responsible for the organization, appointment and dismissal of the staff of the Fund.

(*c*) The Managing Director and the staff of the Fund, in the discharge of their functions, shall owe their duty entirely to the Fund and to no other authority. Each member of the Fund shall respect the international character of this duty and shall refrain from all attempts to influence any of the staff in the discharge of his functions.

(*d*) In appointing the staff the Managing Director shall, subject to the paramount importance of securing the highest standards of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.

SEC. 5. *Voting.*—(*a*) Each member shall have two hundred fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand United States dollars.

(*b*) Whenever voting is required under Article V, Section 4 or 5, each member shall have the number of votes to which it is entitled under (*a*) above, adjusted

(i) by the addition of one vote for the equivalent of each four hundred thousand United States dollars of net sales of its currency up to the date when the vote is taken, or

(ii) by the subtraction of one vote for the equivalent of each four hundred thousand United States dollars of its net purchases of the currencies of other members up to the date when the vote is taken;

provided, that neither net purchases nor net sales shall be deemed at any time to exceed an amount equal to the quota of the member involved.

(*c*) For the purpose of all computations under this Section, United States dollars shall be deemed to be of the weight and fineness in effect on July 1, 1944, adjusted for any uniform change under Article IV, Section 7, if a waiver is made under Section 8 (*d*) of that Article.

(*d*) Except as otherwise specifically provided, all decisions of the Fund shall be made by a majority of the votes cast.

Sec. 6. *Distribution of net income.*—(*a*) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed.

(*b*) If any distribution is made, there shall first be distributed a two percent non-cumulative payment to each member on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year. The balance shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency.

Sec. 7. *Publication of reports.*—(*a*) The Fund shall publish an annual report containing an audited statement of its accounts, and shall issue, at intervals of three months or less, a summary statement of its transactions and its holdings of gold and currencies of members.

(*b*) The Fund may publish such other reports as it deems desirable for carrying out its purposes.

Sec. 8. *Communication of views to members.*—The Fund shall at all times have the right to communicate its views informally to any member on any matter arising under this Agreement. The Fund may, by a two-thirds majority of the total voting power, decide to publish a report made to a member regarding its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments of members. If the member is not entitled to appoint an executive director, it shall be entitled to representation in accordance with Section 3 (*j*) of this Article. The Fund shall not publish a report involving changes in the fundamental structure of the economic organization of members.

Article XIII. Offices and Depositories

Section 1. *Location of offices.*—The principal office of the Fund shall be located in the territory of the member having the largest quota, and agencies or branch offices may be established in the territories of other members.

Sec. 2. *Depositories.*—(*a*) Each member country shall desig-

nate its central bank as a depository for all the Fund's holdings of its currency, or if it has no central bank it shall designate such other institution as may be acceptable to the Fund.

(*b*) The Fund may hold other assets, including gold, in the depositories designated by the five members having the largest quotas and in such other designated depositories as the Fund may select. Initially, at least one-half of the holdings of the Fund shall be held in the depository designated by the member in whose territories the Fund has its principal office and at least forty percent shall be held in the depositories designated by the remaining four members referred to above. However, all transfers of gold by the Fund shall be made with due regard to the costs of transport and anticipated requirements of the Fund. In an emergency the Executive Directors may transfer all or any part of the Fund's gold holdings to any place where they can be adequately protected.

SEC. 3. *Guarantee of the Fund's assets.*—Each member guarantees all assets of the Fund against loss resulting from failure or default on the part of the depository designated by it.

Article XIV. Transitional Period

SECTION 1. *Introduction.*—The Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of the war.

SEC. 2. *Exchange restrictions.*—In the post-war transitional period members may, notwithstanding the provisions of any other articles of this Agreement, maintain and adapt to changing circumstances (and, in the case of members whose territories have been occupied by the enemy, introduce where necessary) restrictions on payments and transfers for current international transactions. Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund; and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability. In particular, members shall withdraw restrictions maintained or imposed under this Section as soon as they are satisfied that

they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund.

SEC. 3. *Notification to the Fund.*—Each member shall notify the Fund before it becomes eligible under Article XX, Section 4 (*c*) or (*d*), to buy currency from the Fund, whether it intends to avail itself of the transitional arrangements in Section 2 of this Article, or whether it is prepared to accept the obligations of Article VIII, Sections 2, 3, and 4. A member availing itself of the transitional arrangements shall notify the Fund as soon thereafter as it is prepared to accept the above-mentioned obligations.

SEC. 4. *Action of the Fund relating to restrictions.*—Not later than three years after the date on which the Fund begins operations and in each year thereafter, the Fund shall report on the restrictions still in force under Section 2 of this Article. Five years after the date on which the Fund begins operations, and in each year thereafter, any member still retaining any restrictions inconsistent with Article VIII, Sections 2, 3, or 4, shall consult the Fund as to their further retention. The Fund may, if it deems such action necessary in exceptional circumstances, make representations to any member that conditions are favorable for the withdrawal of any particular restriction, or for the general abandonment of restrictions, inconsistent with the provisions of any other article of this Agreement. The member shall be given a suitable time to reply to such representations. If the Fund finds that the member persists in maintaining restrictions which are inconsistent with the purposes of the Fund, the member shall be subject to Article XV, Section 2 (*a*).

SEC. 5. *Nature of transitional period.*—In its relations with members, the Fund shall recognize that the post-war transitional period will be one of change and adjustment and in making decisions on requests occasioned thereby which are presented by any member it shall give the member the benefit of any reasonable doubt.

Article XV. Withdrawal from Membership

SECTION 1. *Right of members to withdraw.*—Any member may withdraw from the Fund at any time by transmitting a notice in writing to the Fund at its principal office. Withdrawal shall become effective on the date such notice is received.

SEC. 2. *Compulsory withdrawal.*—(*a*) If a member fails to fulfill any of its obligations under this Agreement, the Fund may declare the member ineligible to use the resources of the Fund. Nothing in this Section shall be deemed to limit the provisions of Article IV, Section 6, Article V, Section 5, or Article VI, Section 1.

(*b*) If, after the expiration of a reasonable period the member persists in its failure to fulfill any of its obligations under this Agreement, or a difference between a member and the Fund under Article IV, Section 6, continues, that member may be required to withdraw from membership in the Fund by a decision of the Board of Governors carried by a majority of the governors representing a majority of the total voting power.

(*c*) Regulations shall be adopted to ensure that before action is taken against any member under (*a*) or (*b*) above, the member shall be informed in reasonable time of the complaint against it and given an adequate opportunity for stating its case, both orally and in writing.

SEC. 3. *Settlement of accounts with members withdrawing.*—When a member withdraws from the Fund, normal transactions of the Fund in its currency shall cease and settlement of all accounts between it and the Fund shall be made with reasonable despatch by agreement between it and the Fund. If agreement is not reached promptly, the provisions of Schedule D shall apply to the settlement of accounts.

Article XVI. Emergency Provisions

SECTION 1. *Temporary suspension.*—(*a*) In the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund, the Executive Directors by unanimous vote may suspend for a period of not more than

one hundred twenty days the operation of any of the following provisions:

(i) Article IV, Sections 3 and 4 (*b*).
(ii) Article V, Sections 2, 3, 7, 8 (*a*) and (*f*).
(iii) Article VI, Section 2.
(iv) Article XI, Section 1.

(*b*) Simultaneously with any decision to suspend the operation of any of the foregoing provisions, the Executive Directors shall call a meeting of the Board of Governors for the earliest practicable date.

(*c*) The Executive Directors may not extend any suspension beyond one hundred twenty days. Such suspension may be extended, however, for an additional period of not more than two hundred forty days, if the Board of Governors by a four-fifths majority of the total voting power so decides, but it may not be further extended except by amendment of this Agreement pursuant to Article XVII.

(*d*) The Executive Directors may, by a majority of the total voting power, terminate such suspension at any time.

SEC. 2. *Liquidation of the Fund.*—(*a*) The Fund may not be liquidated except by decision of the Board of Governors. In an emergency, if the Executive Directors decide that liquidation of the Fund may be necessary, they may temporarily suspend all transactions, pending decision by the Board.

(*b*) If the Board of Governors decides to liquidate the Fund, the Fund shall forthwith cease to engage in any activities except those incidental to the orderly collection and liquidation of its assets and the settlement of its liabilities, and all obligations of members under this Agreement shall cease except those set out in this Article, in Article XVIII, paragraph (*c*), in Schedule D, paragraph 7, and in Schedule E.

(*c*) Liquidation shall be administered in accordance with the provisions of Schedule E.

Article XVII. Amendments.

(*a*) Any proposal to introduce modifications in this Agreement, whether emanating from a member, a governor or the Executive Directors, shall be communicated to the chairman of the Board of Governors who shall bring the proposal before the Board. If the proposed amendment is approved by the Board the Fund shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having four-fifths of the total voting power, have accepted the proposed amendment, the Fund shall certify the fact by a fomal communication addressed to all members.

(*b*) Notwithstanding (*a*) above, acceptance by all members is required in the case of any amendment modifying

(i) the right to withdraw from the Fund (Article XV, Section 1);

(ii) the provision that no change in a member's quota shall be made without its consent (Article III, Section 2);

(iii) the provision that no change may be made in the par value of a member's currency except on the proposal of that member (Article IV, Section 5 (*b*)).

(*c*) Amendments shall enter into force for all members three months after the date of the formal communication unless a shorter period is specified in the circular letter or telegram.

Article XVIII. Interpretation

(*a*) Any question of interpretation of the provisions of this Agreement arising between any member and the Fund or between any members of the Fund shall be submitted to the Executive Directors for their decision. If the question particularly affects any member not entitled to appoint an executive director it shall be entitled to representation in accordance with Article XII, Section 3 (*j*).

(*b*) In any case where the Executive Directors have given a decision under (*a*) above, any member may require that the question be referred to the Board of Governors, whose decision shall be final. Pending the result of the reference to the Board

the Fund may, so far as it deems necessary, act on the basis of the decision of the Executive Directors.

(*c*) Whenever a disagreement arises between the Fund and a member which has withdrawn, or between the Fund and any member during liquidation of the Fund, such disagreement shall be submitted to arbitration by a tribunal of three arbitrators, one appointed by the Fund, another by the member or withdrawing member and an umpire who, unless the parties otherwise agree, shall be appointed by the President of the Permanent Court of International Justice or such other authority as may have been prescribed by regulation adopted by the Fund. The umpire shall have full power to settle all questions of procedure in any case where the parties are in disagreement with respect thereto.

Article XIX. Explanation of Terms

In interpreting the provisions of this Agreement the Fund and its members shall be guided by the following:

(*a*) A member's monetary reserves means its net official holdings of gold, of convertible currencies of other members, and of the currencies of such non-members as the Fund may specify.

(*b*) The official holdings of a member means central holdings (that is, the holdings of its Treasury, central bank, stabilization fund, or similar fiscal agency).

(*c*) The holdings of other official institutions or other banks within its territories may, in any particular case, be deemed by the Fund, after consultation with the member, to be official holdings to the extent that they are substantially in excess of working balances; provided that for the purpose of determining whether, in a particular case, holdings are in excess of working balances, there shall be deducted from such holdings amounts of currency due to official institutions and banks in the territories of members or non-members specified under (*d*) below.

(*d*) A member's holdings of convertible currencies means its holdings of the currencies of other members which are not availing themselves of the transitional arrangements under Article XIV, Section 2, together with its holdings of the cur-

rencies of such non-members as the Fund may from time to time specify. The term currency for this purpose includes without limitation coins, paper money, bank balances, bank acceptances, and government obligations issued with a maturity not exceeding twelve months.

(*e*) A member's monetary reserves shall be calculated by deducting from its central holdings the currency liabilities to the Treasuries, central banks, stabilization funds, or similar fiscal agencies of other members or non-members specified under (*d*) above, together with similar liabilities to other official institutions and other banks in the territories of members, or non-members specified under (*d*) above. To these net holdings shall be added the sums deemed to be official holdings of other official institutions and other banks under (*c*) above.

(*f*) The Fund's holdings of the currency of a member shall include any securities accepted by the Fund under Article III, Section 5.

(*g*) The Fund, after consultation with a member which is availing itself of the transitional arrangements under Article XIV, Section 2, may deem holdings of the currency of that member which carry specified rights of conversion into another currency or into gold to be holdings of convertible currency for the purpose of the calculation of monetary reserves.

(*h*) For the purpose of calculating gold subscriptions under Article III, Section 3, a member's net official holdings of gold and United States dollars shall consist of its official holdings of gold and United States currency after deducting central holdings of its currency by other countries and holdings of its currency by other official institutions and other banks if these holdings carry specified rights of conversion into gold or United States currency.

(*i*) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:

(1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;

(2) Payments due as interest on loans and as net income from other investments;
(3) Payments of moderate amount for amortization of loans or for depreciation of direct investments;
(4) Moderate remittances for family living expenses.

The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions.

Article XX. Final Provisions

SECTION 1. *Entry into force.*—This Agreement shall enter into force when it has been signed on behalf of governments having sixty-five percent of the total of the quotas set forth in Schedule A and when the instruments referred to in Section 2 (*a*) of this Article have been deposited on their behalf, but in no event shall this Agreement enter into force before May 1, 1945.

SEC. 2. *Signature.*—(*a*) Each government on whose behalf this Agreement is signed shall deposit with the Government of the United States of America an instrument setting forth that it has accepted this Agreement in accordance with its law and has taken all steps necessary to enable it to carry out all of its obligations under this Agreement.

(*b*) Each government shall become a member of the Fund as from the date of the deposit on its behalf of the instrument referred to in (*a*) above, except that no government shall become a member before this Agreement enters into force under Section 1 of this Article.

(*c*) The Government of the United States of America shall inform the governments of all countries whose names are set forth in Schedule A, and all governments whose membership is approved in accordance with Article II, Section 2, of all signatures of this Agreement and of the deposit of all instruments referred to in (*a*) above.

(*d*) At the time this Agreement is signed on its behalf, each government shall transmit to the Government of the United States of America one one-hundredth of one percent of its

total subscription in gold or United States dollars for the purpose of meeting administrative expenses of the Fund. The Government of the United States of America shall hold such funds in a special deposit account and shall transmit them to the Board of Governors of the Fund when the initial meeting has been called under Section 3 of this Article. If this Agreement has not come into force by December 31, 1945, the Government of the United States of America shall return such funds to the governments that transmitted them.

(*e*) This Agreement shall remain open for signature at Washington on behalf of the governments of the countries whose names are set forth in Schedule A until December 31, 1945.

(*f*) After December 31, 1945, this Agreement shall be open for signature on behalf of the government of any country whose membership has been approved in accordance with Article II, Section 2.

(*g*) By their signature of this Agreement, all governments accept it both on their own behalf and in respect of all their colonies, overseas territories, all territories under their protection, suzerainty, or authority and all territories in respect of which they exercise a mandate.

(*h*) In the case of governments whose metropolitan territories have been under enemy occupation, the deposit of the instrument referred to in (*a*) above may be delayed until one hundred eighty days after the date on which these territories have been liberated. If, however, it is not deposited by any such government before the expiration of this period the signature affixed on behalf of that government shall become void and the portion of its subscription paid under (*d*) above shall be returned to it.

(*i*) Paragraphs (*d*) and (*h*) shall come into force with regard to each signatory government as from the date of its signature.

SEC. 3. *Inauguration of the Fund.*—(*a*) As soon as this Agreement enters into force under Section 1 of this Article, each member shall appoint a governor and the member having the

largest quota shall call the first meeting of the Board of Governors.

(*b*) At the first meeting of the Board of Governors, arrangements shall be made for the selection of provisional executive directors. The governments of the five countries for which the largest quotas are set forth in Schedule A shall appoint provisional executive directors. If one or more of such governments have not become members, the executive directorships they would be entitled to fill shall remain vacant until they become members, or until January 1, 1946, whichever is the earlier. Seven provisional executive directors shall be elected in accordance with the provisions of Schedule C and shall remain in office until the date of the first regular election of executive directors which shall be held as soon as practicable after January 1, 1946.

(*c*) The Board of Governors may delegate to the provisional executive directors any powers except those which may not be delegated to the Executive Directors.

SEC. 4. *Initial determination of par values.*—(*a*) When the Fund is of the opinion that it will shortly be in a position to begin exchange transactions, it shall so notify the members and shall request each member to communicate within thirty days the par value of its currency based on the rates of exchange prevailing on the sixtieth day before the entry into force of this Agreement. No member whose metropolitan territory has been occupied by the enemy shall be required to make such a communication while that territory is a theater of major hostilities or for such period thereafter as the Fund may determine. When such a member communicates the par value of its currency the provisions of (*d*) below shall apply.

(*b*) The par value communicated by a member whose metropolitan territory has not been occupied by the enemy shall be the par value of that member's currency for the purposes of this Agreement unless, within ninety days after the request referred to in (*a*) above has been received, (i) the member notifies the Fund that it regards the par value as unsatisfactory, or (ii) the Fund notifies the member that in its opinion the par

value cannot be maintained without causing recourse to the Fund on the part of that member or others on a scale prejudicial to the Fund and to members. When notification is given under (i) or (ii) above, the Fund and the member shall, within a period determined by the Fund in the light of all relevant circumstances, agree upon a suitable par value for that currency. If the Fund and the member do not agree within the period so determined, the member shall be deemed to have withdrawn from the Fund on the date when the period expires.

(*c*) When the par value of a member's currency has been established under (*b*) above, either by the expiration of ninety days without notification, or by agreement after notification, the member shall be eligible to buy from the Fund the currencies of other members to the full extent permitted in this Agreement, provided that the Fund has begun exchange transactions.

(*d*) In the case of a member whose metropolitan territory has been occupied by the enemy, the provisions of (*b*) above shall apply, subject to the following modifications:

(i) The period of ninety days shall be extended so as to end on a date to be fixed by agreement between the Fund and the member.

(ii) Within the extended period the member may, if the Fund has begun exchange transactions, buy from the Fund with its currency the currencies of other members, but only under such conditions and in such amounts as may be prescribed by the Fund.

(iii) At any time before the date fixed under (i) above, changes may be made by agreement with the Fund in the par value communicated under (*a*) above.

(*e*) If a member whose metropolitan territory has been occupied by the enemy adopts a new monetary unit before the date to be fixed under (*d*) (i) above, the par value fixed by that member for the new unit shall be communicated to the Fund and the provisions of (*d*) above shall apply.

(*f*) Changes in par values agreed with the Fund under this Section shall not be taken into account in determining whether

a proposed change falls within (i), (ii), or (iii) of Article IV, Section 5 (*c*).

(*g*) A member communicating to the Fund a par value for the currency of its metropolitan territory shall simultaneously communicate a value, in terms of that currency, for each separate currency, where such exists, in the territories in respect of which it has accepted this Agreement under Section 2 (*g*) of this Article, but no member shall be required to make a communication for the separate currency of a territory which has been occupied by the enemy while that territory is a theater of major hostilities or for such period thereafter as the Fund may determine. On the basis of the par value so communicated, the Fund shall compute the par value of each separate currency. A communication or notification to the Fund under (*a*), (*b*) or (*d*) above regarding the par value of a currency, shall also be deemed, unless the contrary is stated, to be a communication or notification regarding the par value of all the separate currencies referred to above. Any member may, however, make a communication or notification relating to the metropolitan or any of the separate currencies alone. If the member does so, the provisions of the preceding paragraphs (including (*d*) above, if a territory where a separate currency exists has been occupied by the enemy) shall apply to each of these currencies separately.

(*h*) The Fund shall begin exchange transactions at such date as it may determine after members having sixty-five percent of the total of the quotas set forth in Schedule A have become eligible, in accordance with the preceding paragraphs of this Section, to purchase the currencies of other members, but in no event until after major hostilities in Europe have ceased.

(*i*) The Fund may postpone exchange transactions with any member if its circumstances are such that, in the opinion of the Fund, they would lead to use of the resources of the Fund in a manner contrary to the purposes of this Agreement or prejudicial to the Fund or the members.

(*j*) The par values of the currencies of governments which indicate their desire to become members after December 31,

1945, shall be determined in accordance with the provisions of Article II, Section 2.

Done at Washington, in a single copy which shall remain deposited in the archives of the Government of the United States of America, which shall transmit certified copies to all governments whose names are set forth in Schedule A and to all governments whose membership is approved in accordance with Article II, Section 2.

Schedule A. Quotas

[In millions of United States dollars]

Australia	200	India	400
Belgium	225	Iran	25
Bolivia	10	Iraq	8
Brazil	150	Liberia	.5
Canada	300	Luxembourg	10
Chile	50	Mexico	90
China	550	Netherlands	275
Colombia	50	New Zealand	50
Costa Rica	5	Nicaragua	2
Cuba	50	Norway	50
Czechoslovakia	125	Panama	.5
Denmark	(1)	Paraguay	2
Dominican Republic	5	Peru	25
Ecuador	5	Philippine Commonwealth	15
Egypt	45	Poland	125
El Salvador	2.5	Union of South Africa	100
Ethiopia	6	Union of Soviet Socialist Republics	1,200
France	450		
Greece	40	United Kingdom	1,300
Guatemala	5	United States	2,750
Haiti	5	Uruguay	15
Honduras	2.5	Venezuela	15
Iceland	1	Yugoslavia	60

1. The quota of Denmark shall be determined by the Fund after the Danish Government has declared its readiness to sign this Agreement but before signature takes place.

Schedule B. Provisions with Respect to Repurchase by a Member of Its Currency Held by the Fund

1. In determining the extent to which repurchase of a member's currency from the Fund under Article V, Section 7 (*b*), shall be made with each type of monetary reserve, that is, with gold and with each convertible currency, the following rule, subject to 2 below, shall apply:

(*a*) If the member's monetary reserves have not increased during the year, the amount payable to the Fund shall be distributed among all types of reserves in proportion to the member's holdings thereof at the end of the year.
(*b*) If the member's monetary reserves have increased during the year, a part of the amount payable to the Fund equal to one-half of the increase shall be distributed among those types of reserves which have increased in proportion to the amount by which each of them has increased. The remainder of the sum payable to the Fund shall be distributed among all types of reserves in proportion to the member's remaining holdings thereof.
(*c*) If after all the repurchases required under Article V, Section 7 (*b*), had been made, the result would exceed any of the limits specified in Article V, Section 7 (*c*), the Fund shall require such repurchases to be made by the members proportionately in such manner that the limits will not be exceeded.

2. The Fund shall not acquire the currency of any nonmember under Article V, Section 7 (*b*) and (*c*).

3. In calculating monetary reserves and the increase in monetary reserves during any year for the purpose of Article V, Section 7 (*b*) and (*c*), no account shall be taken, unless deductions have otherwise been made by the member for such holdings, of any increase in those monetary reserves which is due to currency previously inconvertible having become convertible during the year; or to holdings which are the proceeds of long-term or medium-term loan contracted during the year; or to

holdings which have been transferred or set aside for repayment of loan during the subsequent year.

4. In the case of members whose metropolitan territories have been occupied by the enemy, gold newly produced during the five years after the entry into force of this Agreement from mines located within their metropolitan territories shall not be included in computations of their monetary reserves or of increases in their monetary reserves.

Schedule C. Election of Executive Directors

1. The election of the elective executive directors shall be by ballot of the governors eligible to vote under Article XII, Section 3 (*b*) (iii) and (iv).

2. In balloting for the five directors to be elected under Article XII, Section 3 (*b*) (iii), each of the governors eligible to vote shall cast for one person all of the votes to which he is entitled under Article XII, Section 5 (*a*). The five persons receiving the greatest number of votes shall be directors, provided that no person who received less than nineteen percent of the total number of votes that can be cast (eligible votes) shall be considered elected.

3. When five persons are not elected on the first ballot, a second ballot shall be held in which the person who received the lowest number of votes shall be ineligible for election and in which there shall vote only (*a*) those governors who voted in the first ballot for a person not elected, and (*b*) those governors whose votes for a person elected are deemed under 4 below to have raised the votes cast for that person above twenty percent of the eligible votes.

4. In determining whether the votes cast by a governor are to be deemed to have raised the total of any person above twenty percent of the eligible votes the twenty percent shall be deemed to include, first, the votes of the governor casting the largest number of votes for such person, then the votes of the governor casting the next largest number, and so on until twenty percent is reached.

5. Any governor part of whose votes must be counted in order to raise the total of any person above nineteen percent shall be considered as casting all of his votes for such person

even if the total votes for such person thereby exceed twenty percent.

6. If, after the second ballot, five persons have not been elected, further ballots shall be held on the same principles until five persons have been elected, provided that after four persons are elected, the fifth may be elected by a simple majority of the remaining votes and shall be deemed to have been elected by all such votes.

7. The directors to be elected by the American Republics under Article XII, Section 3 (*b*) (iv) shall be elected as follows:

(*a*) Each of the directors shall be elected separately.

(*b*) In the election of the first director, each governor representing an American Republic eligible to participate in the election shall cast for one person all the votes to which he is entitled. The person receiving the largest number of votes shall be elected provided that he has received not less than forty-five percent of the total votes.

(*c*) If no person is elected on the first ballot, further ballots shall be held, in each of which the person receiving the lowest number of votes shall be eliminated, until one person receives a number of votes sufficient for election under (*b*) above.

(*d*) Governors whose votes contributed to the election of the first director shall take no part in the election of the second director.

(*e*) Persons who did not succeed in the first election shall not be ineligible for election as the second director.

(*f*) A majority of the votes which can be cast shall be required for election of the second director. If at the first ballot no person receives a majority, further ballots shall be held in each of which the person receiving the lowest number of votes shall be eliminated, until some person obtains a majority.

(*g*) The second director shall be deemed to have been elected by all the votes which could have been cast in the ballot securing his election.

Schedule D. Settlement of Accounts with Members Withdrawing

1. The Fund shall be obligated to pay to a member withdrawing an amount equal to its quota, plus any other amounts due to it from the Fund, less any amounts due to the Fund, including charges accruing after the date of its withdrawal; but no payment shall be made until six months after the date of withdrawal. Payments shall be made in the currency of the withdrawing member.

2. If the Fund's holdings of the currency of the withdrawing member are not sufficient to pay the net amount due from the Fund, the balance shall be paid in gold, or in such other manner as may be agreed. If the Fund and the withdrawing member do not reach agreement within six months of the date of withdrawal, the currency in question held by the Fund shall be paid forthwith to the withdrawing member. Any balance due shall be paid in ten half-yearly installments during the ensuing five years. Each such installment shall be paid, at the option of the Fund, either in the currency of the withdrawing member acquired after its withdrawal or by the delivery of gold.

3. If the Fund fails to meet any installment which is due in accordance with the preceding paragraphs, the withdrawing member shall be entitled to require the Fund to pay the installment in any currency held by the Fund with the exception of any currency which has been declared scarce under Article VII, Section 3.

4. If the Fund's holdings of the currency of a withdrawing member exceed the amount due to it, and if agreement on the method of settling accounts is not reached within six months of the date of withdrawal, the former member shall be obligated to redeem such excess currency in gold or, at its option, in the currencies of members which at the time of redemption are convertible. Redemption shall be made at the parity existing at the time of withdrawal from the Fund. The withdrawing member shall complete redemption within five years of the date of withdrawal, or within such longer period as may be fixed by the Fund, but shall not be required to redeem in any half-yearly

period more than one-tenth of the Fund's excess holdings of its currency at the date of withdrawal plus further acquisitions of the currency during such half-yearly period. If the withdrawing member does not fulfill this obligation, the Fund may in an orderly manner liquidate in any market the amount of currency which should have been redeemed.

5. Any member desiring to obtain the currency of a member which has withdrawn shall acquire it by purchase from the Fund, to the extent that such member has access to the resources of the Fund and that such currency is available under 4 above.

6. The withdrawing member guarantees the unrestricted use at all times of the currency disposed of under 4 and 5 above for the purchase of goods or for payment of sums due to it or to persons within its territories. It shall compensate the Fund for any loss resulting from the difference between the par value of its currency on the date of withdrawal and the value realized by the Fund on disposal under 4 and 5 above.

7. In the event of the Fund going into liquidation under Article XVI, Section 2, within six months of the date on which the member withdraws, the account between the Fund and that government shall be settled in accordance with Article XVI, Section 2, and Schedule E.

Schedule E. Administration of Liquidation

1. In the event of liquidation the liabilities of the Fund other than the repayment of subscriptions shall have priority in the distribution of the assets of the Fund. In meeting each such liability the Fund shall use its assets in the following order:

(*a*) the currency in which the liability is payable;
(*b*) gold;
(*c*) all other currencies in proportion, so far as may be practicable, to the quotas of the members.

2. After the discharge of the Fund's liabilities in accordance with 1 above, the balance of the Fund's assets shall be distributed and apportioned as follows:

(*a*) The Fund shall distribute its holdings of gold among the members whose currencies are held by the Fund in amounts less than their quotas. These members shall share the gold so distributed in the proportions of the amounts by which their quotas exceed the Fund's holdings of their currencies.

(*b*) The Fund shall distribute to each member one-half the Fund's holdings of its currency but such distribution shall not exceed fifty percent of its quota.

(*c*) The Fund shall apportion the remainder of its holdings of each currency among all the members in proportion to the amounts due to each member after the distributions under (*a*) and (*b*) above.

3. Each member shall redeem the holdings of its currency apportioned to other members under 2 (*c*) above, and shall agree with the Fund within three months after a decision to liquidate upon an orderly procedure for such redemption.

4. If a member has not reached agreement with the Fund within the three-month period referred to in 3 above, the Fund shall use the currencies of other members apportioned to that member under 2 (*c*) above to redeem the currency of that member apportioned to other members. Each currency apportioned to a member which has not reached agreement shall be used, so far as possible, to redeem its currency apportioned to the members which have made agreements with the Fund under 3 above.

5. If a member has reached agreement with the Fund in accordance with 3 above, the Fund shall use the currencies of other members apportioned to that member under 2 (*c*) above to redeem the currency of that member apportioned to other members which have made agreements with the Fund under 3 above. Each amount so redeemed shall be redeemed in the currency of the member to which it was apportioned.

6. After carrying out the preceding paragraphs, the Fund shall pay to each member the remaining currencies held for its account.

7. Each member whose currency has been distributed to other members under 6 above shall redeem such currency in gold or, at its option, in the currency of the member requesting redemption, or in such other manner as may be agreed between them. If the members involved do not otherwise agree, the member obligated to redeem shall complete redemption within five years of the date of distribution, but shall not be required to redeem in any half-yearly period more than one-tenth of the amount distributed to each other member. If the member does not fulfill this obligation, the amount of currency which should have been redeemed may be liquidated in an orderly manner in any market.

8. Each member whose currency has been distributed to other members under 6 above guarantees the unrestricted use of such currency at all times for the purchase of goods or for payment of sums due to it or to persons in its territories. Each member so obligated agrees to compensate other members for any loss resulting from the difference between the par value of its currency on the date of the decision to liquidate the Fund and the value realized by such members on disposal of its currency.

APPENDIX V

Articles of Agreement

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

United Nations Monetary and Financial Conference
Bretton Woods, N. H., July 1 to 22, 1944

SCHEDULES

Articles of Agreement
International Bank for Reconstruction and Development

The Governments on whose behalf the present Agreement is signed agree as follows:

Introductory Article

The International Bank for Reconstruction and Development is established and shall operate in accordance with the following provisions:

Article I. Purposes

The purposes of the Bank are:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.

(ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is

not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

(iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.

(iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above.

Article II. Membership in and Capital of the Bank

SECTION 1. *Membership.*—(*a*) The original members of the Bank shall be those members of the International Monetary Fund which accept membership in the Bank before the date specified in Article XI, Section 2 (*e*).

(*b*) Membership shall be open to other members of the Fund, at such times and in accordance with such terms as may be prescribed by the Bank.

SEC. 2. *Authorized capital.*—(*a*) The authorized capital stock of the Bank shall be $10,000,000,000 in terms of United States dollars of the weight and fineness in effect on July 1, 1944. The capital stock shall be divided into 100,000 shares having a par value of $100,000 each, which shall be available for subscription only by members.

(*b*) The capital stock may be increased when the Bank

deems it advisable by a three-fourths majority of the total voting power.

SEC. 3. *Subscription of shares.*—(*a*) Each member shall subscribe shares of the capital stock of the Bank. The minimum number of shares to be subscribed by the original members shall be those set forth in Schedule A. The minimum number of shares to be subscribed by other members shall be determined by the Bank, which shall reserve a sufficient portion of its capital stock for subscription by such members.

(*b*) The Bank shall prescribe rules laying down the conditions under which members may subscribe shares of the authorized capital stock of the Bank in addition to their minimum subscriptions.

(*c*) If the authorized capital stock of the Bank is increased, each member shall have a reasonable opportunity to subscribe, under such conditions as the Bank shall decide, a proportion of the increase of stock equivalent to the proportion which its stock theretofore subscribed bears to the total capital stock of the Bank, but no member shall be obligated to subscribe any part of the increased capital.

SEC. 4. *Issue price of shares.*—Shares included in the minimum subscriptions of original members shall be issued at par. Other shares shall be issued at par unless the Bank by a majority of the total voting power decides in special circumstances to issue them on other terms.

SEC. 5. *Division and calls of subscribed capital.*—The subscription of each member shall be divided into two parts as follows:

(i) twenty percent shall be paid or subject to call under Section 7 (i) of this Article as needed by the Bank for its operations;

(ii) the remaining eighty percent shall be subject to call by the Bank only when required to meet obligations of the Bank created under Article IV, Sections 1 (*a*) (ii) and (iii).

Calls on unpaid subscriptions shall be uniform on all shares.

SEC. 6. *Limitation on liability.*—Liability on shares shall be limited to the unpaid portion of the issue price of the shares.

SEC. 7. *Method of payment of subscriptions for shares.*—Payment of subscriptions for shares shall be made in gold or United States dollars and in the currencies of the members as follows:

(i) under Section 5 (i) of this Article, two percent of the price of each share shall be payable in gold or United States dollars, and, when calls are made, the remaining eighteen percent shall be paid in the currency of the member;

(ii) when a call is made under Section 5 (ii) of this Article, payment may be made at the option of the member either in gold, in United States dollars or in the currency required to discharge the obligations of the Bank for the purpose for which the call is made;

(iii) when a member makes payments in any currency under (i) and (ii) above, such payments shall be made in amounts equal in value to the member's liability under the call. This liability shall be a proportionate part of the subscribed capital stock of the Bank as authorized and defined in Section 2 of this Article.

SEC. 8. *Time of payment of subscriptions.*—(*a*) The two percent payable on each share in gold or United States dollars under Section 7 (i) of this Article, shall be paid within sixty days of the date on which the Bank begins operations, provided that

(i) any original member of the Bank whose metropolitan territory has suffered from enemy occupation or hostilities during the present war shall be granted the right to postpone payment of one-half percent until five years after that date;

(ii) an original member who cannot make such a payment because it has not recovered possession of its gold reserves which are still seized or immobilized as a result of the war may postpone all payment until such date as the Bank shall decide.

(*b*) The remainder of the price of each share payable under Section 7 (i) of this Article shall be paid as and when called by the Bank, provided that

(i) the Bank shall, within one year of its beginning operations, call not less than eight percent of the price of the share in addition to the payment of two percent referred to in (*a*) above;
(ii) not more than five percent of the price of the share shall be called in any period of three months.

SEC. 9. *Maintenance of value of certain currency holdings of the Bank.*—(*a*) Whenever (i) the par value of a member's currency is reduced, or (ii) the foreign exchange value of a member's currency has, in the opinion of the Bank, depreciated to a significant extent within that member's territories, the member shall pay to the Bank within a reasonable time an additional amount of its own currency sufficient to maintain the value, as of the time of initial subscription, of the amount of the currency of such member, which is held by the Bank and derived from currency originally paid in to the Bank by the member under Article II, Section 7 (i), from currency referred to in Article IV, Section 2 (*b*), or from any additional currency furnished under the provisions of the present paragraph, and which has not been repurchased by the member for gold or for the currency of any member which is acceptable to the Bank.

(*b*) Whenever the par value of a member's currency is increased, the Bank shall return to such member within a reasonable time an amount of that member's currency equal to the increase in the value of the amount of such currency described in (*a*) above.

(*c*) The provisions of the preceding paragraphs may be waived by the Bank when a uniform proportionate change in the par values of the currencies of all its members is made by the International Monetary Fund.

SEC. 10. *Restriction on disposal of shares.*—Shares shall not be pledged or encumbered in any manner whatever and they shall be transferable only to the Bank.

Article III. General Provisions Relating to Loans and Guarantees

SECTION 1. *Use of resources.*—(*a*) The resources and the facilities of the Bank shall be used exclusively for the benefit of members with equitable consideration to projects for development and projects for reconstruction alike.

(*b*) For the purpose of facilitating the restoration and reconstruction of the economy of members whose metropolitan territories have suffered great devastation from enemy occupation or hostilities, the Bank, in determining the conditions and terms of loans made to such members, shall pay special regard to lightening the financial burden and expediting the completion of such restoration and reconstruction.

SEC. 2. *Dealings between members and the Bank.*—Each member shall deal with the Bank only through its Treasury, central bank, stabilization fund or other similar fiscal agency, and the Bank shall deal with members only by or through the same agencies.

SEC. 3. *Limitations on guarantees and borrowings of the Bank.*—The total amount outstanding of guarantees, participations in loans and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed one hundred percent of the unimpaired subscribed capital, reserves and surplus of the Bank.

SEC. 4. *Conditions on which the Bank may guarantee or make loans.*—The Bank may guarantee, participate in, or make loans to any member or any political subdivision thereof and any business, industrial, and agricultural enterprise in the territories of a member, subject to the following conditions:

(i) When the member in whose territories the project is located is not itself the borrower, the member or the central bank or some comparable agency of the member which is acceptable to the Bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan.

(ii) The Bank is satisfied that in the prevailing market con-

ditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower.

(iii) A competent committee, as provided for in Article V, Section 7, has submitted a written report recommending the project after a careful study of the merits of the proposal.

(iv) In the opinion of the Bank the rate of interest and other charges are reasonable and such rate, charges and the schedule for repayment of principal are appropriate to the project.

(v) In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole.

(vi) In guaranteeing a loan made by other investors, the Bank receives suitable compensation for its risk.

(vii) Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development.

SEC. 5. *Use of loans guaranteed, participated in or made by the Bank.*—(*a*) The Bank shall impose no conditions that the proceeds of a loan shall be spent in the territories of any particular member or members.

(*b*) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.

(*c*) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet

expenses in connection with the project as they are actually incurred.

Article IV. Operations

SECTION 1. *Methods of making or facilitating loans.*—(*a*) The Bank may make or facilitate loans which satisfy the general conditions of Article III in any of the following ways:

(i) By making or participating in direct loans out of its own funds corresponding to its unimpaired paid-up capital and surplus and, subject to Section 6 of this Article, to its reserves.

(ii) By making or participating in direct loans out of funds raised in the market of a member, or otherwise borrowed by the Bank.

(iii) By gauranteeing in whole or in part loans made by private investors through the usual investment channels.

(*b*) The Bank may borrow funds under (*a*) (ii) above or guarantee loans under (*a*) (iii) above only with the approval of the member in whose markets the funds are raised and the member in whose currency the loan is denominated, and only if those members agree that the proceeds may be exchanged for the currency of any other member without restriction.

SEC. 2. *Availability and transferability of currencies.*—(*a*) Currencies paid into the Bank under Article II, Section 7 (i), shall be loaned only with the approval in each case of the member whose currency is involved; provided, however, that if necessary, after the Bank's subscribed capital has been entirely called, such currencies shall, without restriction by the members whose currencies are offered, be used or exchanged for the currencies required to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to such contractual payments on loans guaranteed by the Bank.

(*b*) Currencies received by the Bank from borrowers or guarantors in payment on account of principal of direct loans made with currencies referred to in (*a*) above shall be exchanged for the currencies of other members or reloaned only

with the approval in each case of the members whose currencies are involved; provided, however, that if necessary, after the Bank's subscribed capital has been entirely called, such currencies shall, without restriction by the members whose currencies are offered, be used or exchanged for the currencies required to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to such contractual payments on loans guaranteed by the Bank.

(*c*) Currencies received by the Bank from borrowers or guarantors in payment on account of principal of direct loans made by the Bank under Section 1 (*a*) (ii) of this Article, shall be held and used, without restriction by the members, to make amortization payments, or to anticipate payment of or repurchase part or all of the Bank's own obligations.

(*d*) All other currencies available to the Bank, including those raised in the market or otherwise borrowed under Section 1 (*a*) (ii) of this Article, those obtained by the sale of gold, those received as payments of interest and other charges for direct loans made under Sections 1 (*a*) (i) and (ii), and those received as payments of commissions and other charges under Section 1 (*a*) (iii), shall be used or exchanged for other currencies or gold required in the operations of the Bank without restriction by the members whose currencies are offered.

(*e*) Currencies raised in the markets of members by borrowers on loans guaranteed by the Bank under Section 1 (*a*) (iii) of this Article, shall also be used or exchanged for other currencies without restriction by such members.

SEC. 3. *Provision of currencies for direct loans.*—The following provisions shall apply to direct loans under Sections 1 (*a*) (i) and (ii) of this Article.

(*a*) The Bank shall furnish the borrower with such currencies of members, other than the member in whose territories the project is located, as are needed by the borrower for expenditures to be made in the territories of such other members to carry out the purposes of the loan.

(*b*) The Bank may, in exceptional circumstances when local currency required for the purposes of the loan cannot be raised

by the borrower on reasonable terms, provide the borrower as part of the loan with an appropriate amount of that currency.

(*c*) The Bank, if the project gives rise indirectly to an increased need for foreign exchange by the member in whose territories the project is located, may in exceptional circumstances provide the borrower as part of the loan with an appropriate amount of gold or foreign exchange not in excess of the borrower's local expenditure in connection with the purposes of the loan.

(*d*) The Bank may, in exceptional circumstances, at the request of a member in whose territories a portion of the loan is spent, repurchase with gold or foreign exchange a part of that member's currency thus spent but in no case shall the part so repurchased exceed the amount by which the expenditure of the loan in those territories gives rise to the increased need for foreign exchange.

SEC. 4. *Payment provisions for direct loans.*—Loan contracts under Section 1 (*a*) (i) or (ii) of this Article shall be made in accordance with the following payment provisions:

(*a*) The terms and conditions of interest and amortization payments, maturity and dates of payment of each loan shall be determined by the Bank. The Bank shall also determine the rate and any other terms and conditions of commission to be charged in connection with such loan.

In the case of loans made under Section 1 (*a*) (ii) of this Article during the first ten years of the Bank's operations, this rate of commission shall be not less than one percent per annum and not greater than one and one-half percent per annum, and shall be charged on the outstanding portion of any such loan. At the end of this period of ten years, the rate of commission may be reduced by the Bank with respect both to the outstanding portions of loans already made and to future loans, if the reserve accumulated by the Bank under Section 6 of this Article and out of other earnings are considered by it sufficient to justify a reduction. In the case of future loans the Bank shall also have discretion to increase the rate of commission beyond the above limit, if experience indicates that an increase is advisable.

(*b*) All loan contracts shall stipulate the currency or currencies in which payments under the contract shall be made to the Bank. At the option of the borrower, however, such payments may be made in gold, or subject to the agreement of the Bank, in the currency of a member other than that prescribed in the contract.

(i) In the case of loans made under Section 1 (*a*) (i) of this Article, the loan contracts shall provide that payments to the Bank of interest, other charges and amortization shall be made in the currency loaned, unless the member whose currency is loaned agrees that such payments shall be made in some other specified currency or currencies. These payments, subject to the provisions of Article II, Section 9 (*c*), shall be equivalent to the value of such contractural payments at the time the loans were made, in terms of a currency specified for the purpose by the Bank by a three-fourths majority of the total voting power.

(ii) In the case of loans made under Section 1 (*a*) (ii) of this Article, the total amount outstanding and payable to the Bank in any one currency shall at no time exceed the total amount of the outstanding borrowings made by the Bank under Section 1 (*a*) (ii) and payable in the same currency.

(*c*) If a member suffers from an acute exchange stringency, so that the service of any loan contracted by that member or guaranteed by it or by one of its agencies cannot be provided in the stipulated manner, the member concerned may apply to the Bank for a relaxation of the conditions of payments. If the Bank is satisfied that some relaxation is in the interests of the particular member and of the operations of the Bank and of its members as a whole, it may take action under either, or both, of the following paragraphs with respect to the whole, or part, of the annual service:

(i) The Bank may, in its discretion, make arrangements with the member concerned to accept service payments on the loan in the member's currency for periods not to exceed

three years upon appropriate terms regarding the use of such currency and the maintenance of its foreign exchange value; and for the repurchase of such currency on appropriate terms.

(ii) The Bank may modify the terms of amortization or extend the life of the loan, or both.

SEC. 5. *Guarantees.*—(*a*) In guaranteeing a loan placed through the usual investment channels, the Bank shall charge a guarantee commission payable periodically on the amount of the loan outstanding at a rate determined by the Bank. During the first ten years of the Bank's operations, this rate shall be not less than one percent per annum and not greater than one and one-half percent per annum. At the end of this period of ten years, the rate of commission may be reduced by the Bank with respect both to the outstanding portions of loans already guaranteed and to future loans if the reserves accumulated by the Bank under Section 6 of this Article and out of other earnings are considered by it sufficient to justify a reduction. In the case of future loans the Bank shall also have discretion to increase the rate of commission beyond the above limit, if experience indicates that an increase is advisable.

(*b*) Guarantee commissions shall be paid directly to the Bank by the borrower.

(*c*) Guarantees by the Bank shall provide that the Bank may terminate its liability with respect to interest if, upon default by the borrower and by the guarantor, if any, the Bank offers to purchase, at par and interest accrued to a date designated in the offer, the bonds or other obligations guaranteed.

(*d*) The Bank shall have power to determine any other terms and conditions of the guarantee.

SEC. 6. *Special reserve.*—The amount of commissions received by the Bank under Sections 4 and 5 of this Article shall be set aside as a special reserve, which shall be kept available for meeting liabilities of the Bank in accordance with Section 7 of this Article. The special reserve shall be held in such liquid form, permitted under this Agreement, as the Executive Directors may decide.

SEC. 7. *Methods of meeting liabilities of the Bank in case of defaults.*—In cases of default on loans made, participated in, or guaranteed by the Bank:

(*a*) The Bank shall make such arrangements as may be feasible to adjust the obligations under the loans, including arrangements under or analogous to those provided in Section 4 (*c*) of this Article.

(*b*) The payments in discharge of the Bank's liabilities on borrowings or guarantees under Section 1 (*a*) (ii) and (iii) of this Article shall be charged:

(i) first, against the special reserve provided in Section 6 of this Article;

(ii) then, to the extent necessary and at the discretion of the Bank, against the other reserves, surplus and capital available to the Bank.

(*c*) Whenever necessary to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to similar payments on loans guaranteed by it, the Bank may call an appropriate amount of the unpaid subscriptions of members in accordance with Article II, Sections 5 and 7. Moreover, if it believes that a default may be of long duration, the Bank may call an additional amount of such unpaid subscriptions not to exceed in any one year one percent of the total subscriptions of the members for the following purposes:

(i) To redeem prior to maturity, or otherwise discharge its liability on, all or part of the outstanding principal of any loan guaranteed by it in respect of which the debtor is in default.

(ii) To repurchase, or otherwise discharge its liability on, all or part of its own outstanding borrowings.

SEC. 8. *Miscellaneous operations.*—In addition to the operations specified elsewhere in this Agreement, the Bank shall have the power:

(i) To buy and sell securities it has issued and to buy and sell securities which it has guaranteed or in which it has

invested, provided that the Bank shall obtain the approval of the member in whose territories the securities are to be bought or sold.

(ii) To guarantee securities in which it has invested for the purpose of facilitating their sale.

(iii) To borrow the currency of any member with the approval of that member.

(iv) To buy and sell such other securities as the Directors by a three-fourths majority of the total voting power may deem proper for the investment of all or part of the special reserve under Section 6 of this Article.

In exercising the powers conferred by this Section, the Bank may deal with any person, partnership, association, corporation or other legal entity in the territories of any member.

Sec. 9. *Warning to be placed on securities.*—Every security guaranteed or issued by the Bank shall bear on its face a conspicuous statement to the effect that it is not an obligation of any government unless expressly stated on the security.

Sec. 10. *Political activity prohibited.*—The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

Article V. Organization and Management

Section 1. *Structure of the Bank.*—The Bank shall have a Board of Governors, Executive Directors, a President and such other officers and staff to perform such duties as the Bank may determine.

Sec. 2. *Board of Governors.*—(*a*) All the powers of the Bank shall be vested in the Board of Governors consisting of one governor and one alternate appointed by each member in such manner as it may determine. Each governor and each alternate shall serve for five years, subject to the pleasure of the member appointing him, and may be reappointed. No alternate may

vote except in the absence of his principal. The Board shall select one of the governors as Chairman.

(*b*) The Board of Governors may delegate to the Executive Directors authority to exercise any powers of the Board, except the power to:

(i) Admit new members and determine the conditions of their admission;
(ii) Increase or decrease the capital stock;
(iii) Suspend a member;
(iv) Decide appeals from interpretations of this Agreement given by the Executive Directors;
(v) Make arrangements to cooperate with other international organizations (other than informal arrangements of a temporary and administrative character);
(vi) Decide to suspend permanently the operations of the Bank and to distribute its assets;
(vii) Determine the distribution of the net income of the Bank.

(*c*) The Board of Governors shall hold an annual meeting and such other meetings as may be provided for by the Board or called by the Executive Directors. Meetings of the Board shall be called by the Directors whenever requested by five members or by members having one-quarter of the total voting power.

(*d*) A quorum for any meeting of the Board of Governors shall be a majority of the Governors, exercising not less than two-thirds of the total voting power.

(*e*) The Board of Governors may by regulation establish a procedure whereby the Executive Directors, when they deem such action to be in the best interests of the Bank, may obtain a vote of the Governors on a specific question without calling a meeting of the Board.

(*f*) The Board of Governors, and the Executive Directors to the extent authorized, may adopt such rules and regulations as may be necessary or appropriate to conduct the business of the Bank.

(*g*) Governors and alternates shall serve as such without

compensation from the Bank, but the Bank shall pay them reasonable expenses incurred in attending meetings.

(*h*) The Board of Governors shall determine the remuneration to be paid to the Executive Directors and the salary and terms of the contract of service of the President.

SEC. 3. *Voting.*—(*a*) Each member shall have two hundred fifty votes plus one additional vote for each share of stock held.

(*b*) Except as otherwise specifically provided, all matters before the Bank shall be decided by a majority of the votes cast.

SEC. 4. *Executive Directors.*—(*a*) The Executive Directors shall be responsible for the conduct of the general operations of the Bank, and for this purpose, shall exercise all the powers delegated to them by the Board of Governors.

(*b*) There shall be twelve Executive Directors, who need not be governors, and of whom:

(i) five shall be appointed, one by each of the five members having the largest number of shares;

(ii) seven shall be elected according to Schedule B by all the Governors other than those appointed by the five members referred to in (i) above.

For the purpose of this paragraph, "members" means governments of countries whose names are set forth in Schedule A, whether they are original members or become members in accordance with Article II, Section 1 (*b*). When governments of other countries become members, the Board of Governors may, by a four-fifths majority of the total voting power, increase the total number of directors by increasing the number of directors to be elected.

Executive directors shall be appointed or elected every two years.

(*c*) Each executive director shall appoint an alternate with full power to act for him when he is not present. When the executive directors appointing them are present, alternates may participate in meetings but shall not vote.

(*d*) Directors shall continue in office until their successors are appointed or elected. If the office of an elected director

becomes vacant more than ninety days before the end of his term, another director shall be elected for the remainder of the term by the governors who elected the former director. A majority of the votes cast shall be required for election. While the office remains vacant, the alternate of the former director shall exercise his powers, except that of appointing an alternate.

(*e*) The Executive Directors shall function in continuous session at the principal office of the Bank and shall meet as often as the business of the Bank may require.

(*f*) A quorum for any meeting of the Executive Directors shall be a majority of the Directors, exercising not less than one-half of the total voting power.

(*g*) Each appointed director shall be entitled to cast the number of votes allotted under Section 3 of this Article to the member appointing him. Each elected director shall be entitled to cast the number of votes which counted toward his election. All the votes which a director is entitled to cast shall be cast as a unit.

(*h*) The Board of Governors shall adopt regulations under which a member not entitled to appoint a director under (*b*) above may send a representative to attend any meeting of the Executive Directors when a request made by, or a matter particularly affecting, that member is under consideration.

(*i*) The Executive Directors may appoint such committees as they deem advisable. Membership of such committees need not be limited to governors or directors or their alternates.

SEC. 5. *President and staff.*—(*a*) The Executive Directors shall select a President who shall not be a governor or an executive director or an alternate for either. The President shall be Chairman of the Executive Directors, but shall have no vote except a deciding vote in case of an equal division. He may participate in meetings of the Board of Governors, but shall not vote at such meetings. The President shall cease to hold office when the Executive Directors so decide.

(*b*) The President shall be chief of the operating staff of the Bank and shall conduct, under the direction of the Executive Directors, the ordinary business of the Bank. Subject to the general control of the Executive Directors, he shall be respon-

sible for the organization, appointment and dismissal of the officers and staff.

(*c*) The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of this duty and shall refrain from all attempts to influence any of them in the discharge of their duties.

(*d*) In appointing the officers and staff the President shall, subject to the paramount importance of securing the highest standards of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.

SEC. 6. *Advisory Council.*—(*a*) There shall be an Advisory Council of not less than seven persons selected by the Board of Governors including representatives of banking, commercial, industrial, labor, and agricultural interests, and with as wide a national representation as possible. In those fields where specialized international organizations exist, the members of the Council representative of those fields shall be selected in agreement with such organizations. The Council shall advise the Bank on matters of general policy. The Council shall meet annually and on such other occasions as the Bank may request.

(*b*) Councillors shall serve for two years and may be reappointed. They shall be paid their reasonable expenses incurred on behalf of the Bank.

SEC. 7. *Loan committees.*—The committees required to report on loans under Article III, Section 4, shall be appointed by the Bank. Each such committee shall include an expert selected by the Governor representing the member in whose territories the project is located and one or more members of the technical staff of the Bank.

SEC. 8. *Relationship to other international organizations.*—(*a*) The Bank, within the terms of this Agreement, shall cooperate with any general international organization and with public international organizations having specialized responsibilities in related fields. Any arrangements for such cooperation which would involve a modification of any provision of this

Agreement may be effected only after amendment to this Agreement under Article VIII.

(*b*) In making decisions on applications for loans or guarantees relating to matters directly within the competence of any international organization of the types specified in the preceding paragraph and participated in primarily by members of the Bank, the Bank shall give consideration to the views and recommendations of such organization.

SEC. 9. *Location of offices.*—(*a*) The principal office of the Bank shall be located in the territory of the member holding the greatest number of shares.

(*b*) The Bank may establish agencies or branch offices in the territories of any member of the Bank.

SEC. 10. *Regional offices and councils.*—(*a*) The Bank may establish regional offices and determine the location of, and the areas to be covered by, each regional office.

(*b*) Each regional office shall be advised by a regional council representative of the entire area and selected in such manner as the Bank may decide.

SEC. 11. *Depositories.*—(*a*) Each member shall designate its central bank as a depository for all the Bank's holdings of its currency or, if it has no central bank, it shall designate such other institution as may be acceptable to the Bank.

(*b*) The Bank may hold other assets, including gold, in depositories designated by the five members having the largest number of shares and in such other designated depositories as the Bank may select. Initially, at least one-half of the gold holdings of the Bank shall be held in the depository designated by the member in whose territory the Bank has its principal office, and at least forty percent shall be held in the depositories designated by the remaining four members referred to above, each of such depositories to hold, initially, not less than the amount of gold paid on the shares of the member designating it. However, all transfers of gold by the Bank shall be made with due regard to the costs of transport and anticipated requirements of the Bank. In an emergency the Executive Directors may transfer all or any part of the Bank's gold holdings to any place where they can be adequately protected.

SEC. 12. *Form of holding of currency.*—The Bank shall accept from any member, in place of any part of the member's currency, paid in to the Bank under Article II, Section 7 (i), or to meet amortization payments on loans made with such currency, and not needed by the Bank in its operations, notes or similar obligations issued by the Government of the member or the depository designated by such member, which shall be non-negotiable, non-interest-bearing and payable at their par value on demand by credit to the account of the Bank in the designated depository.

SEC. 13. *Publication of reports and provision of information.*—(*a*) The Bank shall publish an annual report containing an audited statement of its accounts and shall circulate to members at intervals of three months or less a summary statement of its financial position and a profit and loss statement showing the results of its operations.

(*b*) The Bank may publish such other reports as it deems desirable to carry out its purposes.

(*c*) Copies of all reports, statements and publications made under this section shall be distributed to members.

SEC. 14. *Allocation of net income.*—(*a*) The Board of Governors shall determine annually what part of the Bank's net income, after making provision for reserves, shall be allocated to surplus and what part, if any, shall be distributed.

(*b*) If any part is distributed, up to two percent non-cumulative shall be paid, as a first charge against the distribution for any year, to each member on the basis of the average amount of the loans outstanding during the year made under Article IV, Section 1 (*a*) (i), out of currency corresponding to its subscription. If two percent is paid as a first charge, any balance remaining to be distributed shall be paid to all members in proportion to their shares. Payments to each member shall be made in its own currency, or if that currency is not available in other currency acceptable to the member. If such payments are made in currencies other than the member's own currency, the transfer of the currency and its use by the receiving member after payment shall be without restriction by the members.

Article VI. Withdrawal and Suspension of Membership: Suspension of Operations

SECTION 1. *Right of members to withdraw.*—Any member may withdraw from the Bank at any time by transmitting a notice in writing to the Bank and its principal office. Withdrawal shall become effective on the date such notice is received.

SEC 2. *Suspension of membership.*—If a member fails to fulfill any of its obligations to the Bank, the Bank may suspend its membership by decision of a majority of the Governors, exercising a majority of the total voting power. The member so suspended shall automatically cease to be a member one year from the date of its suspension unless a decision is taken by the same majority to restore the member to good standing.

While under suspension, a member shall not be entitled to exercise any rights under this Agreement, except the right of withdrawal, but shall remain subject to all obligations.

SEC. 3. *Cessation of membership in International Monetary Fund.*—Any member which ceases to be a member of the International Monetary Fund shall automatically cease after three months to be a member of the Bank unless the Bank by three-fourths of the total voting power has agreed to allow it to remain a member.

SEC. 4. *Settlement of accounts with governments ceasing to be members.*—(*a*) When a government ceases to be a member, it shall remain liable for its direct obligations to the Bank and for its contingent liabilities to the Bank so long as any part of the loans or guarantees contracted before it ceased to be a member are outstanding; but it shall cease to incur liabilities with respect to loans and guarantees entered into thereafter by the Bank and to share either in the income or the expenses of the Bank.

(*b*) At the time a government ceases to be a member, the Bank shall arrange for the repurchase of its shares as a part of the settlement of accounts with such government in accordance with the provisions of (*c*) and (*d*) below. For this purpose the repurchase price of the shares shall be the value shown by the

books of the Bank on the day the government ceases to be a member.

(*c*) The payment for shares repurchased by the Bank under this section shall be governed by the following conditions:

(i) Any amount due to the government for its shares shall be withheld so long as the government, its central bank or any of its agencies remains liable, as borrower or guarantor, to the Bank and such amount may, at the option of the bank, be applied on any such liability as it matures. No amount shall be withheld on account of the liability of the government resulting from its subscription for shares under Article II, Section 5 (ii). In any event, no amount due to a member for its shares shall be paid until six months after the date upon which the government ceases to be a member.

(ii) Payments for shares may be made from time to time, upon their surrender by the government, to the extent by which the amount due as the repurchase price in (*b*) above exceeds the aggregate of liabilities on loans and guarantees in (*c*) (i) above until the former member has received the full repurchase price.

(iii) Payments shall be made in the currency of the country receiving payment or at the option of the Bank in gold.

(iv) If losses are sustained by the Bank on any guarantees, participations in loans, or loans which were outstanding on the date when the government ceased to be a member, and the amount of such losses exceeds the amount of the reserve provided against losses on the date when the government ceased to be a member, such government shall be obligated to repay upon demand the amount by which the repurchase price of its shares would have been reduced, if the losses had been taken into account when the repurchase price was determined. In addition, the former member government shall remain liable on any call for unpaid subscriptions under Article II, Section 5 (ii), to the extent that it would have been required to respond if the impairment of capital had occurred and the call had been made

at the time the repurchase price of its shares was determined.

(*d*) If the Bank suspends permanently its operations under Section 5 (*b*) of this Article, within six months of the date upon which any government ceases to be a member, all rights of such government shall be determined by the provisions of Section 5 of the Article.

SEC. 5. *Suspension of operations and settlement of obligations.*—(*a*) In an emergency the Executive Directors may suspend temporarily operations in respect of new loans and guarantees pending an opportunity for further consideration and action by the Board of Governors.

(*b*) The Bank may suspend permanently its operations in respect of new loans and guarantees by vote of a majority of the Governors, exercising a majority of the total voting power. After such suspension of operations the Bank shall forthwith cease all activities, except those incident to the orderly realization, conservation, and preservation of its assets and settlement of its obligations.

(*c*) The liability of all members for uncalled subscriptions to the capital stock of the Bank and in respect of the depreciation of their own currencies shall continue until all claims of creditors, including all contingent claims, shall have been discharged.

(*d*) All creditors holding direct claims shall be paid out of the assets of the Bank, and then out of payments to the Bank on calls on unpaid subscriptions. Before making any payments to creditors holding direct claims, the Executive Directors shall make such arrangements as are necessary, in their judgment, to insure a distribution to holders of contingent claims ratably with creditors holding direct claims.

(*e*) No distribution shall be made to members on account of their subscriptions to the capital stock of the Bank until

(i) all liabilities to creditors have been discharged or provided for, and

(ii) a majority of the Governors, exercising a majority of the total voting power, have decided to make a distribution.

(*f*) After a decision to make a distribution has been taken

under (*e*) above, the Executive Directors may by a two-thirds majority vote make successive distributions of the assets of the Bank to members until all of the assets have been distributed. This distribution shall be subject to the prior settlement of all outstanding claims of the Bank against each member.

(*g*) Before any distribution of assets is made, the Executive Directors shall fix the proportionate share of each member according to the ratio of its shareholding to the total outstanding shares of the Bank.

(*h*) The Executive Directors shall value the assets to be distributed as at the date of distribution and then proceed to distribute in the following manner:

(i) There shall be paid to each member in its own obligations or those of its official agencies or legal entities within its territories, insofar as they are available for distribution, an amount equivalent in value to its proportionate share of the total amount to be distributed.

(ii) Any balance due to a member after payment has been made under (i) above shall be paid, in its own currency, insofar as it is held by the Bank, up to an amount equivalent in value to such balance.

(iii) Any balance due to a member after payment has been made under (i) and (ii) above shall be paid in gold or currency acceptable to the member, insofar as they are held by the Bank, up to an amount equivalent in value to such balance.

(iv) Any remaining assets held by the Bank after payments have been made to members under (i), (ii), and (iii) above shall be distributed *pro rata* among the members.

(*i*) Any member receiving assets distributed by the Bank in accordance with (*h*) above, shall enjoy the same rights with respect to such assets as the Bank enjoyed prior to their distribution.

Article VII. Status, Immunities, and Privileges

SECTION 1. *Purpose of Article.*—To enable the Bank to fulfill the functions with which it is entrusted, the status, immunities and privileges set forth in this Article shall be accorded to the Bank in the territories of each member.

SEC. 2. *Status of the Bank.*—The Bank shall possess full juridical personality, and, in particular, the capacity:

(i) to contract;
(ii) to acquire and dispose of immovable and movable property;
(iii) to institute legal proceedings.

SEC. 3. *Position of the Bank with regard to judicial process.*—Actions may be brought against the Bank only in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities. No actions shall, however, be brought by members or persons acting for or deriving claims from members. The property and assets of the Bank shall, wheresoever located and by whomsoever held, be immune from all forms of seizure, attachment or execution before the delivery of final judgment against the Bank.

SEC. 4. *Immunity of assets from seizure.*—Property and assets of the Bank, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation or any other form of seizure by executive or legislative action.

SEC. 5. *Immunity of archives.*—The archives of the Bank shall be inviolable.

SEC. 6. *Freedom of assets from restrictions.*—To the extent necessary to carry out the operations provided for in this Agreement and subject to the provisions of this Agreement, all property and assets of the Bank shall be free from any restrictions, regulations, controls and moratoria of any nature.

SEC. 7. *Privilege for communications.*—The official communications of the Bank shall be accorded by each member the same treatment that it accords to the official communications of other members.

SEC. 8. *Immunities and privileges of officers and employees.*—All governors, executive directors, alternates, officers and employees of the Bank

(i) shall be immune from legal process with respect to acts performed by them in their official capacity except when the Bank waives this immunity;

(ii) not being local nationals, shall be accorded the same immunities from immigration restrictions, alien registration requirements and national service obligations and the same facilities as regards exchange restrictions as are accorded by members to the representatives, officials, and employees of comparable rank of other members;

(iii) shall be granted the same treatment in respect of travelling facilities as is accorded by members to representatives, officials and employees of comparable rank of other members.

SEC. 9. *Immunities from taxation.*—(*a*) The Bank, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation and from all customs duties. The Bank shall also be immune from liability for the collection or payment of any tax or duty.

(*b*) No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to executive directors, alternates, officials or employees of the Bank who are not local citizens, local subjects, or other local nationals.

(*c*) No taxation of any kind shall be levied on any obligation or security issued by the Bank (including any dividend or interest thereon) by whomsoever held

(i) which discriminates against such obligation or security solely because it is issued by the Bank; or

(ii) if the sole jurisdictional basis for such taxation is the place of currency in which it is issued, made payable or paid, or the location of any office or place of business maintained by the Bank.

(*d*) No taxation of any kind shall be levied on any obligation or security guaranteed by the Bank (including any dividend or interest thereon) by whomsoever held

(i) which discriminates against such obligation or security solely because it is guaranteed by the bank; or

(ii) if the sole jurisdictional basis for such taxation is the location of any office or place of business maintained by the Bank.

Sec. 10. *Application of Article.*—Each member shall take such action as is necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in this Article and shall inform the Bank of the detailed action which it has taken.

Article VIII. Amendments

(*a*) Any proposal to introduce modifications in this Agreement, whether emanating from a member, a governor or the Executive Directors, shall be communicated to the Chairman of the Board of Governors who shall bring the proposal before the Board. If the proposed amendment is appproved by the Board the Bank shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having four-fifths of the total voting power, have accepted the proposed amendment, the Bank shall certify the fact by a formal communication addressed to all members.

(*b*) Notwithstanding (*a*) above, acceptance by all members is required in the case of any amendment modifying

(i) the right to withdraw from the Bank provided in Article VI, Section 1;
(ii) the right secured by Article II, Section 3 (*c*);
(iii) the limitation on liability provided in Article II, Section 6.

(*c*) Amendments shall enter into force for all members three months after the date of the formal communication unless a shorter period is specified in the circular letter or telegram.

Article IX. Interpretation

(*a*) Any question of interpretation of the provisions of this Agreement arising between any member and the Bank or between any members of the Bank shall be submitted to the

Executive Directors for their decision. If the question particularly affects any member not entitled to appoint an executive director, it shall be entitled to representation in accordance with Article V, Section 4 (*h*).

(*b*) In any case where the Executive Directors have given a decision under (*a*) above, any member may require that the question be referred to the Board of Governors, whose decision shall be final. Pending the result of the reference to the Board, the Bank may, so far as it deems necessary, act on the basis of the decision of the Executive Directors.

(*c*) Whenever a disagreement arises between the Bank and a country which has ceased to be a member, or between the Bank and any member during the permanent suspension of the Bank, such disagreement shall be submitted to arbitration by a tribunal of three arbitrators, one appointed by the Bank, another by the country involved and an umpire who, unless the parties otherwise agree, shall be appointed by the President of the Permanent Court of International Justice or such other authority as may have been prescribed by regulation adopted by the Bank. The umpire shall have full power to settle all questions of procedure in any case where the parties are in disagreement with respect thereto.

Article X. Approval Deemed Given

Whenever the approval of any member is required before any act may be done by the Bank, except in Article VIII, approval shall be deemed to have been given unless the member presents an objection within such reasonable period as the Bank may fix in notifying the member of the proposed act.

Article XI. Final Provisions

SECTION 1. *Entry into force.*—This Agreement shall enter into force when it has been signed on behalf of governments whose minimum subscriptions comprise not less than sixty-five percent of the total subscriptions set forth in Schedule A and when the instruments referred to in Section 2 (*a*) of this Article have been deposited on their behalf, but in no event shall this Agreement enter into force before May 1, 1945.

SEC. 2. *Signature.*—(*a*) Each government on whose behalf this Agreement is signed shall deposit with the Government of the United States of America an instrument setting forth that it has accepted this Agreement in accordance with its law and has taken all steps necessary to enable it to carry out all of its obligations under this Agreement.

(*b*) Each government shall become a member of the Bank as from the date of the deposit on its behalf of the instrument referred to in (*a*) above, except that no government shall become a member before this Agreement enters into force under Section 1 of this Article.

(*c*) The Government of the United States of America shall inform the governments of all countries whose names are set forth in Schedule A, and all governments whose membership is approved in accordance with Article II, Section 1 (*b*), of all signatures of this Agreement and of the deposit of all instruments referred to in (*a*) above.

(*d*) At the time this Agreement is signed on its behalf, each government shall transmit to the Government of the United States of America one one-hundredth of one percent of the price of each share in gold or United States dollars for the purpose of meeting administrative expenses of the Bank. This payment shall be credited on account of the payment to be made in accordance with Article II, Section 8 (*a*). The Government of the United States of America shall hold such funds in a special deposit account and shall transmit them to the Board of Governors of the Bank when the initial meeting has been called under Section 3 of this Article. If this Agreement has not come into force by December 31, 1945, the Government of the United States of America shall return such funds to the governments that transmitted them.

(*e*) This Agreement shall remain open for signature at Washington on behalf of the governments of the countries whose names are set forth in Schedule A until December 31, 1945.

(*f*) After December 31, 1945, this Agreement shall be open for signature on behalf of the government of any country whose membership has been approved in accordance with Article II, Section 1 (*b*).

(*g*) By their signature of this Agreement, all governments accept it both on their own behalf and in respect of all their colonies, overseas territories, all territories under their protection, suzerainty, or authority and all territories in respect of which they exercised a mandate.

(*h*) In the case of governments whose metropolitan territories have been under enemy occupation, the deposit of the instrument referred to in (*a*) above may be delayed until one hundred and eighty days after the date on which these territories have been liberated. If, however, it is not deposited by any such government before the expiration of this period, the signature affixed on behalf of that government shall become void and the portion of its subscription paid under (*d*) above shall be returned to it.

(*i*) Paragraphs (*d*) and (*h*) shall come into force with regard to each signatory government as from the date of its signature.

SEC. 3. *Inauguration of the Bank.*—(*a*) As soon as this Agreement enters into force under Section 1 of this Article, each member shall appoint a governor and the member to whom the largest number of shares is allocated in Schedule A shall call the first meeting of the Board of Governors.

(b) At the first meeting of the Board of Governors, arrangements shall be made for the selection of provisional executive directors. The governments of the five countries, to which the largest number of shares are allocated in Schedule A, shall appoint provisional executive directors. If one or more of such governments have not become members, the executive directorships which they would be entitled to fill shall remain vacant until they become members, or until January 1, 1946, whichever is the earlier. Seven provisional executive directors shall be elected in accordance with the provisions of Schedule B and shall remain in office until the date of the first regular election of executive directors which shall be held as soon as practicable after January 1, 1946.

(*c*) The Board of Governors may delegate to the provisional executive directors any powers except those which may not be delegated to the Executive Directors.

(*d*) The Bank shall notify members when it is ready to commence operations.

Done at Washington, in a single copy which shall remain deposited in the archives of the Government of the United States of America, which shall transmit certified copies to all governments whose names are set forth in Schedule A and to all governments whose membership is approved in accordance with Article II, Section 1 (*b*).

Schedule A. Subscriptions
(Millions of dollars)

Australia	200	Iran	24
Belgium	225	Iraq	6
Bolivia	7	Liberia	.5
Brazil	105	Luxembourg	10
Canada	325	Mexico	65
Chile	35	Netherlands	275
China	600	New Zealand	50
Colombia	35	Nicaragua	.8
Costa Rica	2	Norway	50
Cuba	35	Panama	.2
Czechoslovakia	125	Paraguay	.8
Denmark	([1])	Peru	17.5
Dominican Republic	2	Philippine Commonwealth	15
Ecuador	3.2	Poland	125
Egypt	40	Union of South Africa	100
El Salvador	1	Union of Soviet Socialist Republics	1,200
Ethiopia	3	United Kingdom	1,300
France	450	United States	3,175
Greece	25	Uruguay	10.5
Guatemala	2	Venezuela	10.5
Haiti	2	Yugoslavia	40
Honduras	1		
Iceland	1		
India	400		
		Total	9,100

1. The subscription of Denmark shall be determined by the Bank after Denmark accepts membership in accordance with these Articles of Agreement.

Schedule B. Election of Executive Directors

1. The election of the elective executive directors shall be by ballot of the Governors eligible to vote under Article V, Section 4 (*b*).

2. In balloting for the elective executive directors, each governor eligible to vote shall cast for one person all of the votes to which the member appointing him is entitled under Section 3 of Article V. The seven persons receiving the greatest number of votes shall be executive directors, except that no person who receives less than fourteen percent of the total of the votes which can be cast (eligible votes) shall be considered elected.

3. When seven persons are not elected on the first ballot, a second ballot shall be held in which the person who received the lowest number of votes shall be ineligible for election and in which there shall vote only (*a*) those governors who voted in the first ballot for a person not elected and (*b*) those governors whose votes for a person elected are deemed under 4 below to have raised the votes cast for that person above fifteen percent of the eligible votes.

4. In determining whether the votes cast by a governor are to be deemed to have raised the total of any person above fifteen percent of the eligible votes, the fifteen percent shall be deemed to include first, the votes of the governor casting the largest number of votes for such person, then the votes of the governor casting the next largest number, and so on until fifteen percent is reached.

5. Any governor, part of whose votes must be counted in order to raise the total of any person above fourteen percent, shall be considered as casting all of his votes for such person even if the total votes for such person thereby exceed fifteen percent.

6. If, after the second ballot, seven persons have not been elected, further ballot shall be held on the same principles until seven persons have been elected, provided that after six persons are elected, the seventh may be elected by a simple majority of the remaining votes and shall be deemed to have been elected by all such votes.

COUNTRIES REPRESENTED AND CHAIRMEN OF DELEGATIONS

AUSTRALIA.—Leslie G. Melville, *Economic Adviser to the Commonwealth Bank of Australia.*

BELGIUM.—Camille Gutt, *Minister of Finance and Economic Affairs.*

BOLIVIA.—Rene Ballivian, *Financial Counselor, Bolivian Embassy, Washington.*

BRAZIL.—Arthur de Souza Costa, *Minister of Finance.*

CANADA.—J. L. Ilsley, *Minister of Finance.*

CHILE.—Luis Alamos Barros, *Director, Central Bank of Chile.*

CHINA.—Hsiang-Hsi K'ung, *Vice President of Executive Yuan and concurrently Minister of Finance; Governor of the Central Bank of China.*

COLOMBIA.—Carlos Lleras Restrepo, *former Minister of Finance and Comptroller General.*

COSTA RICA.—Francisco de P. Gutierrez Ross, *Ambassador to the United States; former Minister of Finance and Commerce.*

CUBA.—E. I. Montoulieu, *Minister of Finance.*

CZECHOSLOVAKIA.—Ladislav Feierabend, *Minister of Finance.*

DOMINICAN REPUBLIC.—Anselmo Copello, *Ambassador to the United States.*

ECUADOR.—Esteban F. Carbo, *Financial Counselor, Ecuadoran Embassy, Washington.*

EGYPT.—Sany Lackany Bey.

EL SALVADOR.—Agustin Alfaro Moran.

ETHIOPIA.—Blatta Ephrem Tewelde Medhen, *Minister to the United States.*

FRENCH DELEGATION.—Pierre Mendes-France, *Commissioner of Finance.*

GREECE.—Kyriakos Varvaressos, *Governor of the Bank of Greece; Ambassador Extraordinary for Economic and Financial Matters.*

GUATEMALA.—Manuel Noriega Morales.

HAITI.—Andre Liautaud, *Ambassador to the United States.*

HONDURAS.—Julian R. Caceres, *Ambassador to the United States.*

ICELAND.—Magnus Sigurdsson, *Manager, National Bank of Iceland.*

INDIA.—Sir Jeremy Raisman, *Member for Finance, Government of India.*

IRAN.—Abol Hassan Ebtehaj, *Governor of National Bank of Iran.*

IRAQ.—Ibrahim Kamal, *Senator and former Minister of Finance.*

LIBERIA.—William E. Dennis, *Secretary of the Treasury.*

LUXEMBOURG.—Hugues Le Gallais, *Minister to the United States.*

MEXICO.—Eduardo Suarez, *Minister of Finance.*

NETHERLANDS.—J. W. Beyen, *Financial Adviser to the Netherlands Government.*

NEW ZEALAND.—Walter Nash, *Minister of Finance; Minister to the United States.*

NICARAGUA.—Guillermo Sevilla Sacasa, *Ambassador to the United States.*

NORWAY.—Wilhelm Keilhau, *Director, Bank of Norway, p. t., London.*

PANAMA.—Guillermo Arango, *President, Investors Service Corporation of Panama.*

PARAGUAY.—Celso R. Velazquez, *Ambassador to the United States.*

PERU.—Pedro Beltran, *Ambassador-designate to the United States.*

PHILIPPINE COMMONWEALTH.—Colonel Andres Soriano, *Secretary of Finance.*

POLAND.—Ludwik Grosfeld, *Minister of Finance.*

UNION OF SOUTH AFRICA.—S. F. N. Gie, *Minister to the United States.*

UNION OF SOVIET SOCIALIST REPUBLICS.—M. S. Stepanov, *Deputy People's Commissar of Foreign Trade.*

UNITED KINGDOM.—Lord Keynes.

UNITED STATES OF AMERICA.—Henry Morgenthau, Jr., *Secretary of the Treasury.*

URUGUAY.—Mario Le Gamma Acevedo, *Expert, Ministry of Finance.*

VENEZUELA.—Rodolfo Rojas, *Minister of the Treasury.*

YUGOSLAVIA.—Vladimir Rybar, *Counselor of the Yugoslav Embassy, Washington.*

Henrik de Kauffmann, *Danish Minister to the United States, in his personal capacity.*

UNITED STATES DELEGATES

HENRY MORGENTHAU, Jr., *Secretary of the Treasury—Chairman.*

FRED M. VINSON, *Director, Office of Economic Stabilization—Vice Chairman.*

DEAN ACHESON, *Assistant Secretary of State.*

EDWARD E. BROWN, *President, First National Bank of Chicago.*

LEO T. CROWLEY, *Administrator, Foreign Economic Administration.*

MARRINER S. ECCLES, *Chairman, Board of Governors of the Federal Reserve System.*

MABEL NEWCOMER, *Professor of Economics, Vassar College.*

BRENT SPENCE, *House of Representatives; Chairman, Committee on Banking and Currency.*

CHARLES W. TOBEY, *United States Senate; Member, Committee on Banking and Currency.*

ROBERT F. WAGNER, *United States Senate; Chairman, Committee on Banking and Currency.*

HARRY D. WHITE, *Assistant to the Secretary of the Treasury.*

JESSE P. WOLCOTT, *House of Representatives; Member, Committee on Banking and Currency.*

INDEX

INDEX